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(29,632)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1923

No. 335

HERMAN G. GERDES, AS TRUSTEE IN BANKRUPTCY OF
ABRAHAM LUSTGARTEN, BANKRUPT, PETITIONER,

vs.

ABRAHAM LUSTGARTEN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SECOND CIRCUIT

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[fol. 1] **UNITED STATES DISTRICT COURT, SOUTHERN
DISTRICT OF NEW YORK**

In Bankruptcy

No. 29252

In the Matter of ABRAHAM LUSTGARTEN, Bankrupt.

REPORT OF SPECIAL MASTER

To the Honorable the Judges of the United States District Court for the Southern District of New York:

I, Peter B. Olney, Jr., the undersigned Referee, to whom, as Special Commissioner, the specifications of objections to the discharge of the above named bankrupt were referred for examination, testimony and report, do hereby report as follows:

On the hearings before me I was attended by Messrs. Zalkin & Cohen, attorneys for Trustee (by Mr. Cohen of counsel); by Messrs. Blumenstiel & Blumenstiel, attorneys for creditors; by L. J. Bershad, Esq., attorney for bankrupt; Albert Falk, Esq., attorney for creditors, and by the bankrupt in person.

The petition in bankruptcy was filed herein on March 1, 1921, which was followed by an adjudication on April 4, 1921.

The only specifications upon which evidence was introduced before me are the following:

[fol. 2] "First—That the said bankrupt gave to the Corn Exchange Bank, an objecting creditor, a certain signed statement, purporting to show its financial condition, which was false and that he obtained credit upon this false statement.

"Second—That the bankrupt fraudulently concealed the sum of \$2,000 which he transferred to Louis Lustgarten, his nephew, in payment of a fictitious debt."

On or about January 4, 1910, the bankrupt, for the purpose of obtaining credit, gave to the Corn Exchange Bank, the objecting creditor, a financial statement of his assets and liabilities as of December 15, 1919. The said financial statement was at variance with the bankrupt's books in two respects: The item shown as merchandise given as \$39,004.97 and item of accounts receivable given as \$30,642.50, the financial statement showing a net surplus of \$58,135.89, whereas the figures from the books show a surplus of only \$23,158.43—the financial statement thus showing an inflation to the extent of \$32,388.46. The bankrupt says that the discrepancy is explained by faulty bookkeeping and that the financial statement truly reflected his financial condition at the time given. Whether the bankrupt's explanation is the true explanation, or whether the financial statement was not a true statement of the condition as

of the date it was given, and if so, whether the bankrupt knew that it was not a true statement, are difficult questions of fact to determine from the evidence before me. In my opinion it is unnecessary to decide these questions of fact. On October 29, 1920, the Corn Exchange Bank loaned to Lustgarten \$5,000 by discounting his note [fol. 3] in that amount. On November 4, 1920, they loaned a further \$5,000 by discounting his note, and on February 11, 1921, discounted an additional note for \$1,000. Representatives of the bank testified that in extending this credit they relied upon the financial statement above mentioned. In view of the financial depression which prevailed in the United States in the year 1920, and of which the Court is bound to take judicial notice, it may well be questioned whether in extending credit on October 20, 1920, and at the subsequent dates above mentioned, the bank did really rely on the statement received in January, 1920, of the bankrupt's financial condition as of December 15, 1919. But assuming that the bank did rely upon the statement, as a matter of law, in my opinion, it had no right to so rely. The statement contained no express provisions as to the length of time when it could be relied upon and no provisions expressly making it a continuing statement. However, the law is that it was a continuing statement, but only for a reasonable time after it was given. Under the business conditions existing in the year 1920 such reasonable time cannot be regarded as extending from January 4th to October 29th, 1920. (In re B. & R. Glove Corporation, U. S. C. C. A., Second Circuit; opinion by Rogers, J., not yet reported.) It follows that the specifications of objections to the discharge of the bankrupt based on the obtaining of credit from the Corn Exchange Bank upon a materially false financial statement have not been sustained and should be dismissed (In re B. & R. Glove Corporation, *supra*; In re Braverman, 199 Fed., 862; 28 A. B. R., 513).

Counsel for the objecting creditor cites the case of Haimowich [fol. 4] vs. Mandel, 243 Fed., 338, as authority for their contention that if the financial statement was false and was relied upon, it was ground for denying the bankrupt's discharge. In the Haimowich vs. Mandel case credits was extended in September, 1912, upon a statement issued in March, 1912. Whereas six months in the year 1912 might well have been considered a reasonable time within which a financial statement could be relied upon, nevertheless, in view of the decision in the B. & R. Glove case above mentioned, from January 4, 1920, to October 29, 1920, was a length of time beyond which, as matter of law, the financial statement could be relied upon.

As to the second specification relied upon, namely, the alleged concealment of \$2,000 from his Trustee in Bankruptcy by the bankrupt by transferring same to his nephew, Louis Lustgarten, in payment of an alleged fictitious debt, the testimony of the bankrupt is that his nephew had continued in his employ for about nine or ten years, and that beginning 1919 the nephew's salary was \$50 per week; that he drew \$30 and left with the bankrupt \$20 for saving purposes. That this arrangement continued throughout 1919. In 1920 his compensation was increased to \$60 per week, he drawing

only \$40 and leaving \$20 with the bankrupt for saving purposes. That in the month of December, 1920, said Louis Lustgarten became engaged to be married and requested the money from his uncle and received same from him as a matter of right. The only evidence offered by the Trustee to contradict the evidence of the bankrupt was of a negative character, namely, that the bankrupt's books did not have an account with Louis Lustgarten showing a credit to him and a debit to the bankrupt of the amount of his wages re-[fol. 5] tained for saving purposes. To be sure, proper bookkeeping would indicate that such an account should have been kept. However, the failure to have done so, is not of itself sufficient to establish that the bankrupt intentionally and fraudulently failed to have such an account in his books. There is nothing before me to show that the Trustee, if such were the fact, could not have called Louis Lustgarten and others as witnesses to show the falsity of the bankrupt's testimony.

No evidence was adduced by the Trustee that the bankrupt was insolvent in December, 1920, when the said payment was made, nor any evidence that Louis Lustgarten received the said money and kept same for the bankrupt under or subject to his control. In my opinion the Trustee has failed to sustain the burden of proof in establishing the specification of objections to the discharge of the bankrupt based on the payment of \$2,000 to Louis Lustgarten.

I therefore report that the specifications of objections not having been established, I recommend that the discharge of the bankrupt be granted.

The special Commissioner has given consideration to this matter on March 10, 17, 24; April 21; May 5; June 28; July 5, 6, 23, 27 and 31, 1922.

The charges of the stenographer, Herman Parkus, are \$6.00.
All of which is respectfully submitted.

Dated, New York, July 31, 1922.

Peter B. Olney, Jr., Special Commissioner.

[fol. 6] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF
NEW YORK

[Title omitted]

SPECIFICATIONS OF OBJECTIONS

The Corn Exchange Bank of New York City, a corporation duly organized and existing under and by virtue of the laws of the State of New York, a creditor of the above bankrupt, having duly filed its appearance in opposition to the discharge of said bankrupt, by Albert Falck, its attorney, objects to the discharge of the said bankrupt, and as grounds for such object-s does file and urge the following specifications, upon information and belief:

First. Said bankrupt, with intent to conceal his true financial condition and the financial condition of his business, while engaged in said business, failed to keep true books of account and records from which his true financial condition might or could be ascertained, in that he failed to record in said books of account obligations due him and moneys received by him; that he failed to keep a true record of the amounts of money due and owing by him; bills and notes payable, and accounts payable by him, outstandings accounts and moneys due him.

[fol. 7] Second. That said bankrupt gave to the Corn Exchange Bank, the objecting creditor herein, a certain signed statement, purporting to show his financial condition. That said statement was made in writing to said Corn Exchange Bank, with the intent and purpose on the part of said bankrupt of having the same circulated to persons to whom he might apply for credit, including your objectors, and that your objectors upon the receipt of such statement and relying upon the same, extended credit to said bankrupt and loaned moneys to him relying thereon. That the said statement is dated January 5, 1920, and purports to show the financial condition of the bankrupt as of December 15, 1919.

Third. The following is a statement of the assets and liabilities as contained in the said statement:

Assets

Merchandise on hand (at cost)	\$39,004.97
Accounts outstanding, due from customers, all good....	30,642.50
Cash on hand	945.63

Cash in the following banks:

Corn Exchange Bank	6,319.31
Chatham & Phenix	2,723.48
Fixtures, present value	1,500.00

Total assets	\$81,135.89
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Liabilities

For merchandise, on open account	\$3,000.00
Borrowed from banks	20,000.00

Total liabilities	\$23,000.00
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Net worth is at least \$58,135.89.

[fol. 8] Fourth. That the said bankrupt knew and had reason to know that the said statement was false and untrue.

Fifth. That the said bankrupt was not at the time of the making of the said statement or at the time the statement purported to show

the condition of the bankrupt worth \$58,135.89, or any like sum: that he did not own personal property of the values stated in said statement; that said properties were not worth the sums stated by him or any like sum; that his liabilities were not the sum of \$23,000, or any like sum, but were greatly in excess thereof. That his total assets were not at either of said times worth \$81,135.89, but were as a matter of fact much less, and known by him so to be. That the personal property was much less than said amount; that the liabilities were greatly in excess of \$23,000 and that his net worth was at said time much less than \$58,135.89.

Wherefore, your petitioner prays for a hearing on the objections raised in these specifications and that the application for a discharge herein be denied.

Dated, New York, December 13th, 1921.

Corn Exchange Bank, By W. E. Frew, President, Petitioner.

[fol. 9] STATE AND COUNTY OF NEW YORK,
Southern District of New York, ss:

Walter E. Frew, being duly sworn deposes and says: That he is the president of the Corn Exchange Bank, the objecting creditor herein; that he has read the foregoing specifications of objections and knows the contents thereof; that the same are true to his own knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters he believes it to be true.

That the reason this verification is not made by the objecting creditor herein is that the said objecting creditor is a corporation, and the grounds of deponent's belief as to all matters in said specifications not stated upon his own knowledge are investigations which deponent has caused to be made concerning the subject-matter of this proceeding, and information acquired by deponent in the course of his duties as such officer of said corporation.

Walter E. Frew.

Sworn to before me this 13th day of December, 1921. E. H. Denike, Notary Public, No. 46, New York County. N. Y. Reg. No. 2248A.

[fol. 10] DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK

[Title omitted]

SPECIFICATIONS

Rusch & Co., creditors and persons interested in the estate of the above-named bankrupt, do hereby oppose the granting of a discharge of said bankrupt from his debts, and for grounds of such opposition

do hereby file the following specifications, upon information and belief:

First. The said bankrupt, with intent to conceal his true financial condition and the financial condition of his business, has destroyed, concealed, or failed to keep correct books of account or records from which such condition might or could be ascertained, and he has knowingly, fraudulently and willfully omitted, or caused to be omitted, entries in certain of his books, in order to mislead his creditors, and conceal from them his true financial condition.

Second. That said bankrupt, while a bankrupt, knowingly, fraudulently and willfully concealed, and still conceals from his trustee in bankruptcy herein, property belonging to his estate in bankruptcy, consisting of moneys of the value of Two thousand (\$2,000) [fol. 11] Dollars and upwards which property he has transferred and conveyed to certain relations in alleged payment of fictitious debts, but which cash and property are being held, in whole or in part, in secret trust for said bankrupt, by his said relations.

Third. He has knowingly and fraudulently made a false oath or account in or in relation to these bankruptcy proceedings, by verifying his schedules in bankruptcy and alleging therein that same contained a statement of all his estate, both real and personal, when, as a matter of fact, the property referred to in specifications "Second" hereof, and other property belonging to his estate in bankruptcy, is not property scheduled therein.

Fourth. That said bankrupt has made false oath in connection with his application for discharge, in that he swore he has no property save such property as has been turned over to his estate in bankruptcy herein, whereas he did not turn over the property claimed to be concealed herein.

Wherefore, objection is made to the discharge of the bankrupt herein, and a hearing and the judgment of the Court is respectfully asked thereon.

Rusch & Co., Objecting Creditor, By ——. Blumenstiel & Blumenstiel, Attorneys for Objecting Creditor, Office & P. O. Address, 165 Broadway, Borough of Manhattan, City of New York.

[fol. 12] UNITED STATES OF AMERICA,
Southern District of New York, ss:

———, being duly sworn, deposes and says: That he is one of the firm of Rusch & Co., objecting creditor herein. That he has read the foregoing specifications and knows the contents thereof, and that the same is true to his own knowledge, except as to those matters therein stated to be alleged upon information and belief, and as to those matters, he believes it to be true.

Sworn to before me this — day of December, 1921.

[fol. 13] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF
NEW YORK

[Title omitted]

HEARING BEFORE SPECIAL MASTER

Before Hon. Peter B. Olney, Jr., Referee

Hearing on Specifications, Objections to Discharge

New York, March 10, 1922—2 o'clock p. m.

Appearances: Messrs. Zalkin & Cohen, Attorneys for Trustees, by Mr. Cohen, of counsel; Messrs. Blumensteil & Blumensteil, Attorneys for Creditors, by Mr. Krinsky, of counsel; L. J. Bershad, Esq., Attorney for Bankrupt; Albert Falk, Esq., Attorney for Creditor, by Mr. Farb, of counsel; Mr. Abraham Lusgarten, the Bankrupt, in person; Mr. William Broomfield, a witness; Ferdinand Schnell, a witness.

[fol. 14] WILLIAM BROOMFIELD, a witness called by the Trustee, having been first duly sworn testified as follows:

Direct examination.

By Mr. Cohen:

Q. Where do you live?

A. 1478 Vyse Avenue, Bronx.

Q. Are you connected with Woods Dry Goods Commercial Agency?

A. Yes.

Q. In what capacity?

A. Reporter.

Q. Have you produced some records here in pursuance to a subpoena duces tecum served on you?

A. I have.

Q. Will you please produce the record?

A. Yes, here they are.

Q. This paper that you produced here, where did you obtain that?

Mr. Bershad: I object to that as incompetent and not the best proof.
The Referee: Qualify him, Mr. Cohen.

Q. What is your connection with Woods Dry Goods Commercial Agency?

A. A reporter.

Q. Was this paper taken from the files of Woods Dry Goods Commercial Agency by you?

Mr. Bershad: I object in the ground it may have been placed there by anybody.

The Referee: Overruled.

Mr. Bershad: Exception.

A. I did.

Q. In what department of Woods Dry Goods Commercial Agency was that filed?

[fol. 15] Mr. Bershad: I object to that as not binding and it is immaterial.

The Referee: Overruled, if he does not connect it you may move to strike it out.

A. In our dead file.

Q. Had you ever seen this statement before this day?

A. Yes.

Q. When was the first time you saw this statement?

A. On or about January 6th, 1920.

Q. Did you receive it from any particular person?

A. No.

Q. How did it first come to your notice?

A. Through the mail.

Mr. Bershad: I object and move to strike the answer out.

The Referee: Overruled.

Mr. Bershad: Exception.

Q. Is this the envelop- in which it came?

Mr. Bershad: Objection.

The Referee: Overruled.

Mr. Bershad: Exception.

A. It is.

Q. Since that time has this document been continually in the files of Woods Dry Goods Commercial Agency as far as you know?

Mr. Bershad: I object to that.

The Referee: Overruled.

Mr. Bershad: Exception.

A. It has.

[fol. 16] Mr. Cohen: I ask that this paper and the envelope be marked for identification.

Paper and envelope marked "Trustee's Exhibit 1 for Identification, March 10th, 1922."

Q. Will you state in a general way what the business of the Woods Commercial Agency is?

A. Furnishing commercial reports to subscribers.

Cross-examination.

By Mr. Bershad:

Q. How long have you been in the Woods Dry Goods Commercial Agency?

A. Over fifteen years.

Q. In what capacity did you first go there?

A. Originally as a boy.

Q. You have nothing to do with the credit department, have you?

A. No, sir.

The credit department is in the hands of some one else?

A. Yes.

Q. That person is not here?

A. I don't understand.

Q. The man or woman who has charge of the credit department is not here in Court?

A. No.

Q. Who has charge of the credit reports in your agency?

A. I don't know what you mean.

Q. Receiving the reports, passing on the reports?

A. A man named Heyser.

Q. He is not here?

A. No.

Q. As far as you know has he any personal knowledge of this statement?

A. Not to my knowledge, I have no idea.

Q. Do you know anybody else who has any knowledge other than yourself?

A. I cannot say.

Q. By looking at this exhibit aside from any independent data [fol. 17] or records, you are unable to say when you first saw this paper, is that correct?

A. Not the exact day, I cannot tell that, no.

Q. Can you say whether you got this paper in 1918, 1919 or 1920?

A. No, I cannot.

Q. You don't even know whether you got this in 1921, the early part of 1921?

A. I cannot say.

Q. You cannot say?

A. Not the exact date.

Q. Can you say whether you got it in 1918, 1919, 1920 or 1921?

A. On or about the date signed here, January 6th.

Q. How do you know that?

A. On our records.

Q. I asked you from records here or any record on this paper here and you answered no?

A. That is right.

Q. So you do not know of your own knowledge when this statement was received by Woods Dry Goods Commercial Agency?

A. On the records here, no.

Q. Did you produce all the records here?

A. No.

Q. You got a subpoena to produce your records?

A. Only the financial statement.

Q. Have you your subpoena here?

A. Yes, sir, here it is.

Q. You did not get this, you took it from the dead files from your office?

A. Yes.

Sworn to before me this — day of March, 1922. — —

[fol. 18] FERDINAND SCHNELL, a witness called by the Trustee, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Cohen:

Q. What is your address?

A. Garwood, New Jersey.

Q. Are you connected with the R. G. Dun Agency?

A. Yes.

Q. In what capacity?

A. Investigator.

Q. What is their business?

A. Giving commercial reports to subscribers.

Q. Have you produced any records here in answer to a subpoena?

A. I did.

Q. Will you show them to me, please.

A. Yes.

Q. This paper and envelope attached which you have produced here, will you kindly state from whom you got it?

A. It was gotten out of our statement files.

Cross-examination.

By Mr. Bershad:

Q. Did you get it out yourself?

Mr. Cohen: I object to that.

The Referee: Overruled.

A. Not myself.

By Mr. Cohen:

Q. Who gave it to you?

A. The young lady in charge of the statement department.

Mr. Bershad: I ask that that answer be stricken out.

The Referee: Overruled.

Q. Do you know how long this paper has been in the possession of the R. G. Dun Company?

A. No.

[fol. 19] Q. Is there any file mark on this paper of the R. G. Dun Company indicating when it was received?

Mr. Bershad: I object, the statement speaks for itself.

The Referee: Overruled.

Mr. Bershad: Exception.

A. Yes.

Q. Will you point it out to me?

A. Yes, here it is.

By Mr. Bershad:

Q. You didn't make this statement?

A. No.

Q. Do you know when this statement or this stamp was placed there?

A. No.

Q. You have no idea whether the stamp was placed there at the time on which this purports to be dated?

A. No.

By Mr. Cohen:

Q. Can you tell us the name of the person in the employ of the R. G. Dun Company who affixed this stamp?

A. No, sir.

Mr. Cohen: I asked that this be marked for identification.

(Paper referred to marked "Trustee's Exhibit 2 for identification, March 10th, 1922.")

Q. Now will you please state the business of the R. G. Dun Company?

A. I did state it.

Mr. Cohen: I withdraw the question.

Sworn to before me this — day of March, 1922.

[fol. 20] ABRAHAM LUSTGARTEN, called as a witness by the Trustee, having been first duly sworn, testified as follows:

(Examination by written interrogatories on account of witness being totally deaf.)

Direct examination.

By Mr. Cohen:

Q. The question I have written here is: Is this signature on this paper signed by you; presenting witness with Trustee's Exhibit No. 2 for identification, March 10th, 1922?

A. This is my signature.

Mr. Cohen: I offer this paper in evidence. (Paper referred to received in evidence and marked, "Trustee's Exhibit 2, March 10, 1922.")

Q. I hand to the witness Trustee's Exhibit 1 for identification, and submit to him the written question: Is this signature yours?

A. Yes, this is my signature.

Mr. Cohen: I offer this paper in evidence. (Paper referred to received in evidence and marked, "Trustee's Exhibit 1, March 10th, 1922.")

Mr. Cohen: The Trustee now offers in evidence the examination of Abraham Lustgarten under Section 21A and at a first meeting of his creditors.

Mr. Bershad: I object to it, it is not competent or material on this proceeding.

The Referee: Has the witness signed the testimony?

[fol. 21] Mr. Cohen: No, sir.

The Referee: You may have the witness read over and sign his testimony and I will then receive it subject to a motion to strike out any parts which Mr. Bershad thinks are incompetent, but it will not be received until it has been gone over and signed by the bankrupt.

Mr. Cohen: I also desire to offer in evidence the testimony of Louis Lustgarten at a first meeting of creditors. My only purpose is to get the admission of Louis Lustgarten that in the month of December, 1920, he received \$2,000 in installments of \$1,000 each.

The Referee: Supposing you let Mr. Bershad have that testimony and he can look it over and he may stipulate what you wish.

Mr. Cohen: Very well, sir.

Sworn to before me this — day of March, 1922. — — —

Adjourned to March 17th, 1923, 3:30 P. M.

[fol. 22] Re ABRAHAM LUSTGARTEN, Bankrupt
 Before Hon. Peter B. Olney, Jr., Special Master
 Adjourned Hearing Specifications

New York, March 17th, 1922—3:30 o'clock, p. m.

Present: The Master, Mr. Cohen, Mr. Bershad, Mr. Falk, Mr. Stillman, Mr. Horton, Mr. Barrett, Mr. Lustgarten.

ABRAHAM LUSTGARTEN recalled:

(Examination by written interrogatories.)

Direct examination.

By Mr. Cohen:

Q. Is that your signature?

A. Yes.

Mr. Cohen: I offer this statement in evidence.

Mr. Bershad: There is more than one statement and they all look alike; I object, the testimony is already before the Court, it is cumulative.

The Master: Overruled.

[fol. 23] Mr. Bershad: I object further on the ground the contents are already before the Court.

The Master: Overruled.

Statement referred to received in evidence and marked, "Trustee's Exhibit 1, March 17th, 1922."

Mr. Bershad: May I ask that only the written part be put in; it does not appear he signed it with full knowledge of its contents.

The Master: Overruled.

Sworn to before me this — day of March, 1922. — — —

WILLIAM B. HORTON, a witness called by the Trustee, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Cohen:

Q. Are you connected with the Corn Exchange Bank?

A. Yes.

Q. In what capacity?

A. Manager of the Fifth Avenue branch.

Q. Is the Corn Exchange Bank a creditor of the bankrupt Lustgarten?

A. Yes.

Q. For what?

A. I think \$11,000.

Q. What is the nature of the obligation?

A. Three promissory notes.

Q. I show you three documents and ask you whether these are the three notes which constitute the claim of the Corn Exchange [fol. 24] Bank?

A. These are the notes.

Q. Are you familiar with the signature of Abraham Lustgarten?

A. Yes.

Q. Do you identify his signature on these notes?

A. Yes, sir.

Mr. Cohen: I offer in evidence these three notes.

Notes referred to received in evidence and marked as one exhibit, "Trustee's Exhibit 2, March 17th, 1922."

Q. Mr. Horton, were these notes which are now marked Trustee's Exhibit 2 of this date presented to you personally for discount?

A. Two of them were.

Q. Did you have before you this paper, Trustee's Exhibit 1 of this date, at that time?

A. Yes, sir, we had this statement at that time.

Mr. Bershad: I move to strike out the answer as not responsive.

The Master: Overruled.

Mr. Bershad: Exception.

Q. When you discounted these two notes did you rely on this statement?

Mr. Bershad: I object to that as leading.

The Master: Reframe the question.

Q. What did you do when the notes were presented to you for discount?

A. We referred to our credit file of which this statement was a part.

Q. Did you examine the credit file?

A. Yes.

Q. Did you rely upon your credit file?

[fol. 25] Mr. Bershad: I object to that as leading.

The Master: Overruled.

By the Master:

Q. Did you examine your credit file before you gave him any money on the notes?

A. Yes.

By Mr. Cohen:

Q. Did you rely upon that statement when you discounted these notes?

Mr. Bershad: I object to that as calling for a conclusion.

The Master: Overruled.

Mr. Bershad: Exception.

A. I did.

By the Master:

Q. Did you have any other information other than what is contained on that paper as to this man's financial responsibility?

A. Not at all.

Q. You didn't know personally how that got into your files?

A. Yes, I did know it was handed to us by his representative.

Mr. Bershad: I move to strike out the answer as not responsive.

The Master: Sustained.

By Mr. Cohen:

Q. Who handed it to you?

A. Hyman Josephson.

Sworn to before me this — day of March, 1922. — — —.

[fol. 26] ABRAHAM LUSTGARTEN, resumes the stand:

By the Master:

Q. Who is Hyman Josephson, do you know?

A. I have no such name on the books at all, I never heard that name at all, I don't know what he is.

Sworn to before me this — day of March, 1922. — — —.

Mr. Bershad: I ask that the testimony of the previous witness with reference to the obtaining of this statement be stricken out.

The Master: Overruled: he testified he received it from a man named Hyman Josephson, the rest has been stricken out.

Mr. Bershad: Exception.

WILLIAM C. HORTON, resumes the stand:

Cross-examination.

By Mr. Bershad:

Q. How long have you been with the Corn Exchange Bank?

A. Close to twenty-five years.

Q. How long in the credit department?

A. I never was in the credit department.

Q. What department are you in?

A. I am the manager of the bank, that branch.

Q. Who is the credit man?

A. I am.

Q. You supervise the credits?

A. Yes, of our branch, not of the bank.

[fol. 27] Q. Of the Corn Exchange branch at Fifth Avenue?

A. Yes.

Q. That is where the bankrupt had an account?

A. Yes.

By the Master:

Q. The bankrupt had an account with your bank?

A. Yes, in our branch.

By Mr. Bershad:

Q. How long have you been the manager of the branch?

A. Since August, 1918, I think.

Q. How long prior to October 9th, 1920, had you known the bankrupt?

A. I cannot say as to that, I have known him as a customer of the bank.

Q. All you knew was the account appearing on the books?

A. Yes, to the best of my recollection, I met him probably once or twice.

Q. If you met him outside you would not know him?

A. I don't know whether I would or not.

Q. The name of Abraham Lustgarten was only identified to you by the fact that you had such an account?

A. Yes, his was simply a business account.

Q. In other words you could not offhand fix a picture of the bankrupt in your mind before October, 1920?

A. I would not say that.

Q. Did you, as a matter of fact, know him?

A. I knew him as a customer of the bank.

Q. Did you know his face?

A. Yes, I knew his face, yes, I knew Abraham Lustgarten.

Q. Without him announcing who he was would you know him if he came in and sat down?

A. I cannot say positively, I may and I may not.

[fol. 28] Q. Just examine this Trustee's Exhibit 1 and tell me when you received that?

A. It was received on January 6th, 1920.

Q. Is there a notation there in your own handwriting?

A. Not mine.

Q. In whose handwriting is that?

A. The assistant manager.

Q. And that purports to be the date you got it in your bank?

A. That is the date.

Q. As far as you know?

A. Yes.

Q. When for the first time did you have occasion to examine this paper?

A. I don't keep any record of the time I look at the papers, I refer to them as notes are offered for discount.

Q. When did you first have occasion to refer to it with reference to any notes to be discounted?

A. I cannot say as to that, I would only be guessing.

Q. You answered Mr. Cohen that you referred to that statement in extending credit to the bankrupt, is that correct?

A. Yes, sir.

Q. Is that true with reference to each one of the three notes?

A. With reference to the two notes.

Q. Which of the two notes?

A. I can tell by looking at the notes.

Q. There are two \$5,000 notes, and one \$1,000 note?

A. I cannot tell without seeing the notes.

Q. Would not the amounts refresh your recollection?

A. No, I cannot answer without seeing the notes.

Q. Look at this note dated February 11th, 1921, \$1,000, did you have this statement before you at the time that credit was extended?

A. I didn't pass on that note, our assistant manager passed on that note.

[fol. 29] Mr. Bershad: May I ask this note be marked as a separate exhibit.

The Master: Yes, call it "A."

Note referred to marked "A."

Q. So that you personally had nothing to do with the extension of the credit of \$1,000 on this note?

A. I don't know what you mean, he has had a standing line of credit with us.

Q. Referring to this particular note when it was presented for discount, you say some one else in your bank passed on that particular credit?

A. That is right.

Q. Therefore you personally do not recall or you did not really have this statement in checking this note?

A. I didn't check this note.

Q. You didn't personally?

A. What do you mean?

Q. You answered Mr. Cohen that you relied on the contents of this statement?

A. Yes.

Q. So I say in checking the credit on this note you didn't rely on this statement?

A. I didn't check that credit.

Q. Was the statement or was it not relied on as far as you know?

A. I don't know what the assistant manager did.

Q. You don't know if the assistant manager did or not?

A. I have no information on that point at all.

Q. Look at this paper dated October 29th, 1920, a note for \$5,000, did you pass that credit?

A. I did.

Q. Are you sure about that?

A. Yes.

Q. Are there any records?

A. Yes.

Mr. Bershad: May I have this note marked B.

[fol. 30] The Master: Yes.

Note referred to marked "B."

Q. And this note, did you pass on that?

A. Yes, I passed on this the same way.

Mr. Bershad: Please mark this C.

Note referred to marked "C."

Q. You didn't talk to Mr. Lustgarten at the time these papers were presented?

A. I don't remember whether I did or not.

Q. What line of credit did he have with your bank?

A. I don't remember offhand, I think it was \$15,000 that he could have credit for, that is my impression.

Q. Have you any idea now at the time the paper of October, 1920, was presented, how much he had in the bank?

A. No, sir.

Q. You referred to his account at the time he came to your place?

A. What account?

Q. His record of what he owed you?

A. Yes.

Q. Do you know what he owed the bank on October 20th, 1920?

A. No, not without looking at the records.

Q. Have you any records with you?

A. No, sir.

Q. Or on November 4th, 1920?

A. I cannot tell offhand.

Q. Did you have any conversation with him at the time this note of \$5,000 was presented for discount?

A. I don't remember, I don't recall.

Q. You would not say that you did have a conversation with him at that time?

A. I said I don't recall whether I did or whether I did not.

Q. And the same answer holds true about the note of November 4th, 1920?

A. If that is one of the notes I initialed, yes.

[fol. 31] Q. Who was your assistant?

A. Charles A. Ingalls.

Q. Is he still with you?

A. Yes, he is still with us.

Q. Can you state to his Honor any conversation that you had with this bankrupt at any time that you talked with him?

A. No, I cannot state any conversation I had with him.

Q. Would you say you had any conversation or you don't recall it?

A. I don't say I never conversed with him, I converse with dozens of people every day.

Q. Don't you keep a credit file of each particular man?

A. I do.

Q. Don't you jot down memorandums of conversations you had with them?

A. Not unless it is of importance.

Q. Would you not regard the offering of paper to the extent of \$10,000 of sufficient importance to make memorandums?

A. No, that is all in our books.

Q. Your books would not show any conversation you would have with the customer about his account?

A. It has been Mr. Lustgarten's practice to send a clerk with his note when offered for discount.

Q. You say a clerk presented this paper?

A. I said it was his custom, I don't know who presented these papers, Mr. Lustgarten or his clerk.

By the Master:

Q. What was the name of the clerk he sent, if you know?

A. I don't know the name of the clerk, his clerk used to come to the bank every day and attend to his banking business.

[fol. 32] By Mr. Bershad:

Q. Did you see the clerk daily?

A. No, occasionally.

Q. Why did you say he came every day?

A. I said daily.

Q. You didn't see him daily?

A. No, I saw him coming in and out of the bank at times.

Q. How would you know it was his clerk?

A. I saw the pass book and checks.

Q. You say you saw him daily?

A. No, I didn't say I saw him every day.

Q. In passing credits—question withdrawn—who drew this statement up?

A. I don't know.

Q. That is a form you have in your bank?

A. Yes.

Q. Are the figures before you mentally without looking at this statement?

A. No.

Q. Will you please look at the figures and analyze them?

A. In what way?

- Q. Familiarize yourself?
- A. Yes, I have.
- Q. Are there any particular figures there you relied on?
- A. I relied on them as a whole.
- Q. On the net figures?
- A. No, the whole statement, both assets and liabilities.
- Q. Let's take item by item; item, merchandise on hand, \$39,004.97, did you scrutinize that item?
- A. What do you mean?
- Q. By finding out the character of the merchandise?
- A. No.
- Q. That is customary to do, is it not, with careful credit men?
- A. No, I would not say so.
- Q. Outstanding accounts, \$30,642.50, did you scrutinize this?
- A. This reads: "Outstanding accounts good?" We relied entirely on the customer's statement that the accounts were all good.
- [fol. 33] Q. Did you rely particularly on that item?
- A. No, no more than on the others.
- Q. Or the item, Corn Exchange Bank, \$6,319.31, you had that on deposit at the time, did you not?
- A. Yes.
- Q. That was on January 10th, 1920?
- A. Yes.
- Q. Can you tell me what balance if any he had in your bank at the time of the presentation of this paper?
- A. I cannot say without referring to the ledger.
- Q. Did you refer to the ledger when the paper was presented?
- A. I don't think so.
- Q. Did you refer to the ledger when the paper of October 5th was presented?
- A. I cannot say whether I did or not.
- Q. Skipping to the items of liabilities, I notice here an item of merchandise for merchandise on open accounts, \$3,000, did you notice that item?
- A. Yes, I saw it.
- Q. Is there anything about that item to attract your attention?
- A. No.
- Q. Would not that figure appear to be rather unusual, a round figure item like that?
- A. No.
- Q. Do you mean to tell me that would not attract your attention?
- A. No, I answered that I believe.
- Q. Did you ask him about?
- A. No, I didn't ask him anything about the \$3,000.
- Q. You had it before you?
- A. Yes.
- Q. When a man is presenting paper to you for \$10,000—question withdrawn— Here he has outstanding accounts close to \$31,000 and he had as his open accounts \$3,000, is that not an unusual situation?
- A. No, sir; not at all.

Q. When he discounted these two notes, do you recall whether [fol. 34] he had anything—question withdrawn— Then I understand you correctly to state you relied on each figure there?

A. I relied on the statement as a whole.

Q. On each figure?

A. I relied on the statement as a whole, the body of the statement.

Q. That inventory there was as of December 15th, 1919, is that right?

A. The statement so says.

Q. That shows the condition you relied on was as of December 15th, 1919?

A. Yes.

Q. The loan of October 29th, 1920, and November 4th, 1920, were almost a year later?

A. Yes.

Q. Do you still persist in saying you made no comment on these figures?

A. I did not.

Q. You are not interested to inquire whether there had been a change in the condition: the credit obtained from you personally was almost ten or eleven months later, didn't you as a practical credit man know there must have been a change in his condition?

A. I know there is a change every day.

Q. Surely there was a change in the period of ten months, so that it could not be the same as it purported to appear on Trustee's Exhibit 1?

A. There is a clause in this statement which he swore to, which says, "And further, whenever my financial condition is changed materially, etc."; we also relied on that.

Q. You knew, however, in spite of the contents of this clause that it was a physical impossibility that that condition of his should have continued the same for almost ten months?

A. As I said before, a man's condition changes all the time.

Q. So I say you knew that you were not relying on the figures in here?

A. I was relying on substantially the same condition, not on the same figures, but on the same condition.

[fol. 35] Q. You knew that that condition as evidenced in this statement ten months later could not be the same?

A. I said that, yes.

Q. Therefore, you could not have relied on these figures?

A. I relied on his net worth being the same.

Q. Do I understand you correctly to state you relied on the net worth? A. I relied on the whole statement.

Q. Did you rely on the net worth?

A. I relied on the statement as a whole.

Q. You knew the figures could not be the same?

Mr. Cohen: I object to that as repetition.

The Master: Sustained.

Q. Am I correct in stating you relied on the statement in this statement that in the event of a change in his condition, he would notify you?

A. I relied on the statement as a whole, of which this is a part.

Q. You will pardon me, my knowledge of credits may not be as extensive as yours, but I know a credit man tries to——

Mr. Cohen: I object to that as argumentative.

The Master: Sustained.

Q. Did you, sir rely on any particular figures there or any particular statement or on the entire statement knowing that condition must have changed?

A. I relied on the entire statement.

Q. Is that the best answer you can give me?

A. Yes, sir; that is the best answer I can give you.

Sworn to before me this — day of March, 1922. — — —.

[fol. 36] Mr. Cohen: I offer in evidence these checks which have been marked Trustee's Exhibit 4 as of August 11th, 1921, which were identified in connection with the testimony of the bankrupt at the first meeting of creditors.

Mr. Bershad: No objection.

PERCY F. BARRETT, a witness called by the Trustee, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Cohen:

Q. What is your business or profession?

A. Certified public accountant.

Q. Where did you receive your education?

A. New York University, and I hold a C. P. A. from the New York State Regents Board.

Q. How long have you been a C. P. A.?

A. Since 1915.

Q. Have you since then been continuously engaged in accounting?

A. Yes.

Q. Are you connected with Lewis C. Getting at the present time?

A. Yes.

Q. In connection with the bankruptcy of Abraham Lustgarten, did you audit some books?

A. Yes.

Q. I show you these books on the table, Exhibits 1 to 6, and ask you whether you made an audit and took an accounting of these books?

A. Yes, sir.

Q. Were you assisted by anybody?

A. An assistant from our office.

[fol. 37] Q. Substantially the greater part of the work was done by yourself?

Mr. Bershad: I object to that as calling for a conclusion.

Mr. Cohen: Question withdrawn.

Q. What part was done by yourself and what part by your assistant?

A. I worked on the general ledger and he prepared schedules of customers.

Q. One of the exhibits there is marked "Salesmen's Commission Book;" will you identify which exhibit that is?

A. That is Exhibit 5, August 11th, 1922.

Q. In the course of your examination and audit of these books, did you examine this book, Exhibit 5?

A. Yes, sir.

Q. In going through that book did you find any entry of the name of Louis Lustgarten?

A. No.

Q. What are the entries made in that book?

A. From the way this book is kept it appears they kept an account with each salesman.

Mr. Bershad: I ask that this witness be told to testify on what he saw.

Mr. Cohen: He is an expert, and as such is permitted to draw conclusions.

The Master: Overruled.

Mr. Bershad: I take an exception to all this line of questioning.

Q. You may continue, Mr. Barrett.

A. There are accounts in this book with various salesmen in which the salesman is given credit for sales made to various customers, and they are itemized down here and his commission figured up.

[fol. 38] Q. I ask you whether you find an entry in any other one of the books of any payment made to Louis Lustgarten?

A. I do.

Q. Please pick out the book and name the book and the exhibit number?

A. General Ledger, Exhibit 4.

Q. Will you please turn to the entry in the book last mentioned where the name of Louis Lustgarten appears and tell us what entries you find?

A. On page 45 under the heading, "Commission on sales," December 8th, there is an entry of \$1,000, and December 22nd, \$1,000, which is posted from the cash book, page 37, December, 1920.

Q. Will you resume in connection with the entries in the cash book?

A. That indicates that Louis Lustgarten was paid \$1,000 on De-

ember 8th and \$1,000 on December 22nd, as shown on entries on page 37 of the cash book.

Q. Did you find anywheres in the books a credit to any account of Louis Lustgarten to offset these debits?

A. I did not.

Q. Now, Mr. Barrett, in connection with your audit of these books did you examine the books and strike a balance as of December 15th, 1919?

Mr. Bershad: I object to that as calling for a conclusion of the witness' mind.

The Master: Overruled.

Mr. Bershad: Exception.

A. I did.

Q. Will you kindly state to the Court just what you did for the purpose of casting the balance sheet from these books as of December 15th, 1919?

A. These are my working sheets on that. I prepared a balance sheet from his general ledger as of December 15th, 1919, and found [fol. 39] the debits and credits to be in balance.

Q. Let me interrupt to ask this: did you find any trial balance entry in the books as of that day, December 15th, 1919?

A. I do not recall.

Q. The trial balance that you found for that day was made by you from the books you found in the place, from the figures in the books?

A. Yes, sir.

Q. I want to direct your attention to the trial balance that you struck as of December 15th, 1919, in connection with the amount of cash in bank, what did you find that item to be?

A. \$9,042.79.

Q. Did you find anything with respect to the amount of cash on hand?

A. There was nothing on the books to show cash on hand.

Q. In connection with the item of merchandise what did you find?

A. The merchandise as shown on his books amounted to \$24,721.17.

Q. Now I direct your attention to the item of machinery and fixtures, how did that appear on the books as of that date?

A. \$848.35.

Q. I now call your attention to the item of accounts receivable, how did that appear on the books as of that date?

A. \$9,053.25.

Q. Was there also an item of assets which he called "Contractors" that you found?

A. Yes, \$5,071.87.

Q. What is meant by that item, "Contractors"?

A. The garment makers sublet work to contractors, and that would represent money due him from contractors for merchandise due.

Q. What is the sum total of the assets you found on this trial balance?

A. \$48,737.43.

Q. Now, sir, I direct your attention to the statement of liabilities that you found in this trial balance, and ask you to tell us what [fol. 40] these items were?

A. Accounts payable, \$5,373.32; notes payable, \$20,000.

Q. Is there any other item of liability that you found?

A. Reserve for discount on sales, \$205.68, and capital account \$23,158.43.

By the Master:

Q. What was that?

A. That would be his net worth, the difference between his assets and his liabilities.

By Mr. Bershad:

Q. What are the total liabilities?

A. \$25,579.

Q. Leaving a net worth of \$23,158.43?

A. Yes.

Sworn to before me this — day of March, 1922. — — —.

Adjourned to March 24th, 1922, 3.30 p. m.

Re ABRAHAM LUSTGARTEN, Bankrupt

Before Hon. Peter B. Olney, Jr., Special Master

Adjourned Hearing on Specifications

New York, March 24th, 1922—3 o'clock, p. m.

Present: The Master, Mr. Cohen, Mr. Bershad, Mr. Ingalls, Mr. Barrett.

[fol. 41] CHARLES A. INGALLS, a witness called by the bankrupt, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Bershad:

Q. Please look at this statement, Trustee's Exhibit 1?

A. Yes.

Q. Where did you get that?

A. It was handed to me at my desk.

- Q. Who handed it to you?
A. Mr. Joseph.
Q. The only way you know it is the notation that appears on that paper?
A. I asked his name.
Q. You made that notation?
A. Yes.
Q. You don't know him?
A. I would not say that.
Q. Do you know him?
A. Yes, sir.
Q. Do you know the bankrupt?
A. I cannot say I could pick him out, I have met him.
Q. What is the date of the statement?
A. December 15th, 1919.
Q. Did you pass on that credit for the bank?
A. Yes.
Q. Did you extend any loans to the bankrupt?
A. Yes, sir.
Q. Do you know how many loans you extended to him?
A. I recall one.
Q. Which one was that?
A. A thousand dollars.
Q. This note of February 11th, 1921, Trustee's Exhibit 2?
A. Yes, sir.
Q. Did you personally attend to this transaction?
A. Yes, sir.
Q. Did you have any talk with the bankrupt at the time?
A. No, sir.
Q. Did you see the bankrupt?
A. No, sir.
[fol. 42] Q. Do you know when this paper was presented to you?
A. Yes.
Q. State as near as you can what occurred at that particular time when this paper was put in for discount?
A. I called for the folder which carries the credit information of Mr. Lustgarten and found he was entitled to the \$1,000.
The Master: Strike that out, what he found.
Q. What conversation did you have?
A. I had no conversation.
Q. Do you know who handed in this note for discount?
A. No.
Q. All you know is this note was handed in by some one and after that you went to your credit file and took out your credit reports, and what did you do then, did you refer to your ledger?
A. Just a minute, I took out the credit information and found this man was entitled to this discount.
Mr. Bershad: I ask that that be stricken out.
The Master: Granted.

Q. Did you take that paper out from your file?

A. Yes.

Q. Did you examine it before extending credit or discounting the note?

A. Yes, sir.

Q. Then what did you do?

A. I initialed the note and gave the discount to him.

Q. How many accounts have you in your bank?

A. Between two thousand five hundred and three thousand.

Q. You do not carry a line of credit of each man in your mind, do you?

A. No, sir.

[fol. 43] Q. Do you carry the line of credit of the active accounts?

A. No, sir.

Q. At the time that you took out this paper did you know how much the bankrupt was indebted to the bank?

A. Yes, sir.

Q. Did you refer to the ledger?

A. Yes, sir.

Q. You did not write up the ledger, nor have you anything to do with the entries?

A. No.

Q. Did you make any memorandum there in your own handwriting as to the limit of the credit?

A. No.

Q. Did you have any notations recorded in your ledger as to the line of credit to which this man was entitled?

A. No, sir.

Q. What line of credit was the bankrupt here getting from your bank at the time?

A. I think it was \$11,000.

Q. Did you fix that?

A. No.

Q. Who fixed that?

A. The board of directors.

Q. Was that the limit of his line?

A. No, sir.

Q. He had not exceeded his limit?

A. No.

Q. How much was his limit with your bank?

A. I think it was \$15,000, I did not look at the books at all.

Q. You stated you looked at that statement and in looking at that statement did you examine the item, merchandise on hand?

A. Yes, sir.

Q. Did you examine the amounts or the items following that?

A. Yes, sir.

Q. And proceeding further down, did you examine the item, cash on hand?

A. Yes, sir.

Q. And the amounts mentioned there, Corn Exchange Bank, and the fixtures?

A. Yes, sir.

Q. Now, what particular item was, in your opinion used as a credit item, did you rely on any particular item in checking the credit?

A. I would not rely on any one figure.

[fol. 44] Q. You would not or you did not?

A. I did not.

Q. Did you look at the item there on the liability side for merchandise on open accounts, \$3,000?

A. Yes, sir.

Q. Borrowed from banks \$20,000?

A. Yes, sir.

Q. That was before you?

A. Yes, sir.

Q. At that time you said he already had \$10,000?

A. Yes, about that.

Q. Did you scrutinize this item, borrowed from banks \$20,000?

A. I took it all in.

Q. Did you scrutinize it?

A. I don't know what you mean.

Q. Did you analyze it?

A. Yes.

Q. How did you scrutinize it?

A. I don't know what you mean, I looked at it.

Q. Did it attract your attention?

A. Yes.

Q. Was that, that item of \$20,000 and your item of \$10,000 that would make an item of \$30,000?

A. No, sir.

Q. You didn't so regard it?

A. No.

Q. How did you treat that \$20,000?

A. Borrowed from banks, \$10,000 was ours.

Q. \$10,000 from your bank and \$10,000 from other banks?

A. Yes, sir.

Q. Didn't these figures attract your attention at all as to the reason why this man needed more money in view of the fact his liabilities for open accounts was only \$3,000 and he had on deposit almost \$10,000?

Mr. Cohen: I object, the question assumes a statement of facts that are not shown, this statement is dated December, 1919, the question is highly unfair.

The Master: Sustained.

Mr. Bershad: Exception.

[fol. 45] Q. Now, you knew, didn't you, Mr. Ingalls, that these figures of February 11th, 1921, could not possibly be the same as they were on the 15th of December, 1919?

A. Naturally they could not be.

Q. You knew then, did you not that there was a change in his condition?

A. Certainly, there must have been.

Q. And you knew when you say you relied on these figures as a whole that these figures could not possibly be as recorded in that statement?

A. I did.

Q. You did not as a matter of fact rely on these figures on February 11th, 1921, that is correct, is it not?

A. If you speak of the figures, yes, if you speak of the whole statement, no.

Q. So you could not rely on these figures?

A. You could rely on them.

Q. On these figures, item after item?

A. If a man sells one thing he puts it down on the other side and that does not affect the totals; if he sells his goods he has outstandings or something like that.

Q. Without knowing if the goods were sold at a loss and these figures could not be the same, they must have shifted?

A. Yes, every day.

Q. Did you talk to any one about this matter?

A. Mr. Horton.

Q. Did he state what testimony he gave here the last time?

A. In a general way.

Q. Did you discuss it with him?

A. Not particularly, I just got back today, I was sick.

Q. He told you what testimony he gave here?

A. Yes.

Q. He asked you to refresh your recollection as to the transaction?

A. Yes.

Q. He aided you, did he not?

A. No, not at all.

[fol. 46] By Mr. Cohen:

Q. In connection with your testimony that the figures had changed, or that you did not rely on the figures, what did you actually rely on when you had that statement in front of you?

A. The whole statement calls for the man's condition on a certain date, we presume that to be the same unless he notifies us it is different.

Q. What you mean is, you do not depend on any individual figure but you depend on the net results in coming to a conclusion as to how much credit he should get?

Mr. Bershad: I object to that as leading.

The Master: Overruled.

Mr. Bershad: Exception.

A. Yes.

By the Master: \

Q. Is there a provision on that statement that any material change in the condition will be reported by the person making it?

A. There is, yes.

Q. Did you have that in mind when you examined the statement?

A. Always.

By Mr. Bershad:

Q. Do I understand you to contend that the bankrupt was in the habit of telling you every month or so the change in these figures, do you contend he could do that?

A. If he had proper books, he could.

Sworn to before me this — day of March, 1922. — — —.

[fol. 47] PERCY S. BARRETT recalled.

Cross-examination.

By Mr. Bershad:

Q. Mr. Barrett, did you notice that the handwriting in the books of the bankrupt after January, 1920, was different than the handwriting which appeared in the books up to December 31st, 1920?

A. I do not recall, there was different handwriting, but just what period it covered I do not remember.

Q. Can you by looking at it state?

A. There is various kinds of handwriting, but I am not qualified to answer as an expert on handwriting.

Q. Do you remember your testimony at the last hearing that you testified there was merchandise on hand with contractors of \$5,-071.87?

A. I stated the contractors' accounts showed a debit balance of that amount.

Q. What does that mean?

A. It may mean merchandise billed to them to be manufactured against which the contractor will charge them with the finished goods and there may be various items of cash, it is not necessarily merchandise.

Q. It may be an account receivable?

A. It is practically an account receivable, it may be for merchandise or it may be advances of money.

Q. How did you treat it?

A. As an asset.

Q. Distinguishing between an account receivable and merchandise, how did you call it?

A. I called it an asset.

Q. From what books did you extract that item?

A. From the general ledger, there may possibly be a little adjustment there, I will have to look. That is in the general ledger.

Q. Was that the statement of merchandise, \$24,721.17, that is in [fol. 48] correct, is it not?

A. You mean on his financial report.

Q. No, what you have extracted from the books.

A. The contractors' accounts show \$5,071.87, I am not speaking about his merchandise account.

Q. I am now directing your attention to the merchandise account, \$24,721.17?

A. The merchandise account appears on his books at \$24,721.17.

Q. How did you distribute this item of \$5,071.87?

A. It is an asset, I did not distribute it.

Q. Did you call it an account?

A. I called it an asset, I am only distributing according to his books, I did not go into details to find out from each contractor's account.

Q. You analyzed the statements and you proceeded to classify each of the items into a particular category to which each item belonged?

A. I showed that according to his books, he classified them, I did not.

Q. This item of \$5,071.87 you designed the last time as contractor's garments on hand or in the hands of contractors, did you not?

A. I have no recollection of designating it that way.

Q. If you did classify it that way were you in error?

A. I am not attempting to classify it and never did attempt to classify it. I took it from his books on page 150.

Q. So you did not analyze the different books to see whether the items constituting that were correct, did you?

Mr. Cohen: I object to that as already answered.

The Master: Sustained.

Q. Did you go to the sources to ascertain whether the figures there reflected on page 150 in red ink, whether they showed up some- [fol. 49] whereas else?

A. This general ledger was in balance, I did not go back.

Q. So if there had been an error you would have no way of knowing it?

A. Not in detail.

Q. Either in detail or any other way?

A. His general ledger was in balance.

By the Master:

Q. What does that mean exactly?

A. The general ledger, his controlling account and accounts receivable, accounts payable and contractors' accounts, there is one account for each classification in the general ledger in which the totals only are posted. This contractor's account does not reflect the name of the various contractors, it contains only totals.

By Mr. Bershad:

Q. Mr. Barrett, do you know whether any entries were omitted in that book as near as you can ascertain?

A. In what way?

Q. To show his financial condition?

A. His books were in balance.

Q. I did not ask you that; I asked you whether you knew whether any entries were omitted, have you any way of determining that?

A. No.

Q. Do you know whether his books were audited by the Internal Revenue Department?

A. No.

Q. Did you know they sent him a bill, an additional bill for \$1,200?

A. No.

Q. So, therefore, as a matter of fact, you cannot state of your own knowledge whether the figures you have given represent his financial condition as of that date?

[fol. 50] A. I can state they represent his financial condition as shown by the books.

Q. You cannot state from your own personal knowledge whether or not these figures as given by you represent his actual condition whether from the books or otherwise?

A. I know nothing except what his books show.

Q. You have not got inventories here?

A. His book inventory.

By the Master:

Q. Can you state his financial condition according to what book?

A. The general ledger.

Q. Any other books?

A. The other books which are summarized in the general ledger.

Q. Are the other books correctly summarized in the general ledger?

A. To the best of my knowledge, yes.

Q. You checked them up?

A. Yes, a reasonable check.

By Mr. Bershad:

Q. Is it a fact you cannot determine the correct financial condition from any book unless certain closing entries are made in the books?

A. The closings had been made.

Q. Please answer the question?

A. The closing entries would not have to be made.

Q. You would have to have some supplemental figures?

A. Yes, an inventory figure.

Q. That you did not have?

A. It was shown in the books as of December 15th.

Q. Did you have the contractor's inventory book?

A. I don't know about the contractor's books.

Q. You gave me that from the memorandum that appeared in

[fol. 51] the ledger but you did not have the contractor's inventory book, did you?

A. I stated I gave you the contractor's accounts, whether that included inventory or not, I do not know.

Q. Therefore whatever figures you took you assumed these figures were the inventory of the contractor's items?

A. No, I stated plainly the figures are shown on the book, on the general ledger.

By the Master:

Q. There is a whole page for contractor's account?

A. Yes.

Q. There is an item which shows a balance of \$6,114.87?

A. Yes.

Q. The red ink shows less bills of two people, leaving a balance of \$5,017.87?

A. Yes.

Q. Was this entry in there when you got the book?

A. Yes, sir.

By Mr. Bershad:

Q. Mr. Barrett, is it not possible the contractors might have had a lot of finished garments in their possession that had not been billed and returned to the bankrupt?

A. That would not affect their account.

Q. I did not ask you that?

A. It is possible that they did, yes.

Q. You have no way of determining whether the bankrupt did have?

A. I cannot answer the question intelligently.

By the Master:

Q. Did you have such knowledge other than what would appear on the books of the bankrupt?

A. No, sir.

[fol. 52] By Mr. Bershad:

Q. How can you ascertain the financial condition then if you did not know the amount of the garments belonging to the bankrupt in the hands of contractors?

Mr. Cohen: I object to that as already answered.

The Master: Sustained, he has testified as to the financial condition as he found it.

Mr. Bershad: Exception.

Q. Mr. Barreet, in analyzing the statement as drawn up from the figures by yourself and the statements given to the bank on December 15th, there are two items that stand out, the item of mer-

chandise on hand and outstanding accounts, all the other items balance substantially?

A. That is up to Mr. Cohen.

Mr. Cohen: I will concede the machinery and figures vary to the extent of about \$700 and the other two items vary greatly.

Mr. Mershad: Will it be conceded the testimony given by Mr. Barrett is only in regard to the figures taken from the books?

Mr. Cohen: Yes, and he has so testified.

Q. You stated at the last hearing you had some one assisting you on the books?

A. Yes, sir.

Q. I ask what work was done by your assistant?

A. Preparing schedules, accounts receivable and accounts payable.

Q. You did not prepare them yourself?

A. No, sir.

[fol. 53] Q. You relied on the figures as given to you by your assistant, did you or did you not?

A. Yes, I did.

By the Master:

Q. You testified last time that you had gone all over the matter and in general checked up the work?

A. Yes, sir.

By Mr. Bershad:

Q. Item for item?

A. In general.

Q. What do you mean in general?

A. I did not check over every individual item back to the beginning of these books.

Q. I did not say you did.

A. That is what I mean, in general I did check them.

Q. You do not know what extracts your assistant made other than the results he gave you and you used these figures?

A. The work that he did was the subsidiary ledger of which the various accounts receivable, accounts payable, and contractors have control accounts in the general ledger.

Q. You used these figures in making up your statement?

A. I used the control.

By the Master:

Q. So the work you did was of such a nature that if there were any material errors made by your assistant you would have found them?

Mr. Bershad: I object to that.

The Master: Overruled.

Mr. Bershad: Exception.

A. Yes.

Q. How?

A. As I explained before the controlling account of the accounts receivable, accounts payable, and so forth, showed only totals, each [fol. 54] individual item being posted into the customer's ledger and naturally when you make a schedule of the individual accounts it should agree with your summary control in the general ledger.

By Mr. Bershad:

Q. So that if an entry had been made by the bookkeeper in the summary which would agree in the detail, you would not detect that, would you?

A. They agreed with the balance.

Q. Did the balance of the controlling accounts agree with the subsidiary accounts?

Mr. Cohen: I object, the witness has testified the matters he referred to were the figures given by his assistant and that if the figures given by his assistant varied he would know an error was made by his assistant.

The Master: Sustained as to the form.

Mr. Bershad: Exception.

By Mr. Cohen:

Q. Will you please tell the Court how the contractor's accounts are handled in the books?

A. The merchandise is billed to the contractor, he performs the work and bills the goods back to the manufacturer.

Q. How are the entries made in the books to cover these transactions?

A. They had a contractor's account which I referred to; raw material contractor's and a finished goods contractor's account. When material was shipped to the contractor, raw material, the contractor is charged with the raw material and the raw material account is credited; when the goods come back from the contractor, the con-[fol. 55] tractor's account is credited and finished goods are charged and any money paid to the contractor is charged to him and credited to cash.

Q. So that in any particular instance if merchandise was in the hands of the contractors if it did not appear in the inventory of merchandise it appeared as an asset charged against the contractor?

A. Yes, sir.

Q. When you spoke of these items of contractors before you intended to include in that asset either merchandise in the hands of the contractors or an obligation from the contractor to the bankrupt but that you could not determine from the books whether or not the particular item was a charge or represented actual merchandise?

Mr. Bershad: I object.

The Master: Yes, objection sustained.

Mr. Cohen: Question withdrawn.

By Mr. Bershad:

Q. Was it possible from the nature of the accounts as kept for you to determine whether the item of assets you include in your inventory of December 15th, 1919, was actual merchandise in the hands of the contractor or whether it was a debt due from the contractor to the bankrupt?

A. I cannot state that positively without an analysis of each account.

Q. In any event, Mr. Barrett, this item of contractors which you gave the bankrupt credit for is an item which he did not credit himself with in the financial report which is now in evidence, is that no- so?

A. I show it as an asset and he does not.

Q. It is quite possible to owe a contractor and yet the net contractors inventory would still show he owed the bankrupt merchant [fol. 56] dise?

A. He owes either finished goods or money from the goods he got from the principal.

Q. By way of illustration; if \$5,000 worth of merchandise was shipped to the contractor it is charged to him at the profit of the finished garments, that is correct, is it not?

A. I cannot tell how they handled this particular account.

Q. You cannot determine from that how that particular contractor's item was treated by the bankrupt?

A. I can tell in this way; when he charges the contractor with say \$5,000 worth of goods he credits this other account with \$5,000 which is reflected in his profit or loss in due course.

Q. You cannot determine whether that is the price of the finished garments or the raw material.

A. I do not know what you are driving at.

Q. The bankrupt sends goods to the contractor and he charges it to him at the finished price?

A. Yes, and he credits a purchasing account for the same amount.

Q. What did he do in this particular account?

— He credited the purchasing account.

By the Master:

Q. These are the books you used, are they not?

A. Yes.

The Master: Is it conceded these books are all that was kept by the bankrupt.

Mr. Bershad: Yes, sir.

Q. You have examined all these books in making your account?

A. Yes, sir.

Sworn to before me this — day of March, 1922. — — —.

Adjourned to April 7th, 1922, 3:15 P. M.

[fol. 57] Before Hon. Peter B. Olney, Jr., Special Master.

Adjourned Hearing on Specifications

New York, April 21st, 1922—3.30 p. m.

Present: The Master, Mr. Saper, Mr. Bershad, Mr. Lustgarten.

ABRAHAM LUSTGARTEN, the bankrupt, called as a witness in his own behalf, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Bershad:

Q. Can you tell me the name of the people who worked for you shortly before the making of the statement which I show you, yes or no? A. That statement is Trustee's Exhibit, being the financial statement made to the Corn Exchange Bank?

A. I don't remember her name.

Q. How long after December 15th, 1919, did this bookkeeper work with you, and how did she come to leave? Explain to the Referee.

A. She left a few days after December 15th; I couldn't agree with her on the price, and I had to let her go.

Q. I show you this statement to the Chatham & Phoenix Bank, and direct your attention to the item, "Merchandise on hand, \$39,004.97," and ask you to state whether on the 15th day of December, 1919, you [fol. 58] had merchandise on hand amounting to \$39,000?

A. On December 15th, 1919, I had woollens, piece goods to the amount of \$24,721.17. This was taken by the bookkeeper from the stock book. This amount of \$24,721.17 does not represent the complete inventory. The complete inventory amounted to \$30,004.97. The complete inventory included all the merchandise I had on that day in the place, included all piece goods, all linings, all silks, all satins, velvets, mercerized goods, and also included the made up merchandise, consisting of coats, suits, dresses, capes, wraps; it also included all paper boxes, all wrapping paper, and all packing paper and twine and trimmings and buttons and braids, stationery and printing—everything, the value of the merchandise I had in the place, taken at cost price, less discounts amounted to \$39,004.97, the actual amount to the penny.

Q. The item of merchandise of \$24,721.17, as appearing in your books, as testified to by Mr. Barrett, the accountant for the Trustee, what did that represent; what did that include?

A. This included the woolen piece goods only. That was taken from the stock book. The other merchandise we didn't keep no stock books for.

Q. Was it made up or piece goods only?

A. The \$24,000 was piece goods only.

Q. The balance of this amount of merchandise on hand consisted of what?

A. I have explained what the balance of merchandise was.

Q. The Trustee's account showed that your books as of December 15th, 1919, record accounts receivable, \$9,053.25. The statement given to the bank shows outstanding accounts, \$30,642.50. How do you explain this difference, if you can explain same?

A. On December 15th, 1919, I had \$9,053.25 accounts receivable. [fol. 59] I had \$5,071.81 in the hands of contractors. On December 15th, I had about \$6,000 merchandise outstanding with my four salesmen. I had one salesman in San Francisco, one salesman in Chicago, one salesman in Boston, and one salesman in Baltimore. On the 15th day of December, 1919, I had about \$4,000 merchandise outstanding with some of my customers, which was shipped to them on approval. This merchandise was posted in the customers' memo. book; also, the salesmen's samples was posted in the salesmen's memo. book. On the 15th day of December, 1919, in the evening, before we went home, my bookkeeper submitted to me the financial report, showing me and explaining me each and every item separate. She showed me that she had charge slips on her desk for merchandise that was shipped during the day, and a few days prior to that day, to the amount of about \$6,000, which was not charged on account she didn't had no time to charge it, she was busy of working on closing the books. In all the total amount of accounts receivable amounted to \$30,642.50, the actual amount to the penny.

Q. You said the bookkeeper showed you \$6,000 outstanding accounts not posted? Is it \$6,000 or \$16,000—which do you mean?

A. \$6,000. We had about \$6,000 worth of merchandise on the desk—I mean, she had about \$6,000 charge slips on the desk, which was not posted—was shipped to the customers but was not posted. In all, the entire amount, with the merchandise in the salesmen's hands, and with the merchandise to customers that was shipped on approval.

Q. How much merchandise in the salesmen's hands?

A. I explained how much, \$6,000. I had. The four salesmen had [fol. 60] about \$6,000, and about \$4,000 was with the customers, shipped to them on approval, and about \$6,000 was merchandise on the desk, without being charged.

Q. So that, on December 15th, 1919, you had outstanding accounts of how much?

A. On the 15th day of December, I had accounts receivable, \$30,642.50.

Q. As is shown in this statement to the Corn Exchange Bank?

A. The actually amount what it shows.

Q. I direct your attention to the item, "Fixtures, present value, \$1,500," and ask you to state whether on December 15th, 1919, you had fixtures of that value. Explain that item.

A. The fixtures and machinery account.

Q. That's right?

A. I had bought an adding machine and some wooden forms and typewriting machine, which added up the difference between \$848.35 and \$1,500.

Q. During the year 1920, was an audit made of your books by the

Internal Revenue Department of the United States Government, if you know, and was there an additional tax assessed against you?

A. I had a young man that made up the income tax report on the end of February, 1920.

Q. Were the statements which you gave to the Corn Exchange Bank and to the creditors at large and the figures contained in such statements true—yes or no?

A. The statement that I gave to the bank and some of the general creditors was absolutely true statement, to the best of my knowledge.

Sworn to before me this — day of April, 1922. — — —.

[fol. 61] JOSEPH WECHSLER, called as a witness on behalf of the Bankrupt, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Bershad:

Q. What is your business, Mr. Wechsler?

A. I am a public accountant.

Q. And have you been a public accountant for how long?

A. About eight years.

Q. During which time have you had experience in auditing books of various mercantile concerns?

A. I have.

Q. During your experience, have you had occasion to audit books of account of concerns doing business similar to the business of the bankrupt herein?

A. I have.

Q. Are you familiar with the method in which the cloak and suit merchants conduct their business and keep their books?

A. I am.

Q. Did you, sir, at my request, look over the books of the bankrupt in this proceeding?

A. I did.

Q. After looking over the books of the bankrupt in this proceeding, did you make extracts from the said books, and did you make an audit and an examination of some of the items?

A. I did.

Q. State to his Honor what you found after such audit?

A. I found that the books had not been properly closed as of December 15th. It is customary to post all the purchases and sales up to the very end of the year. In this case there was no such posting made. The purchases and sales were not posted from the first of December to the 15th of December, and I noticed some red figures put in later, which was evidently done by some accountant who attempted to close the books some time maybe a year or so [fol. 62] later. From the looks of the books it struck me that the

bookkeeper didn't know how to close them, and may have balled the thing up very badly.

Mr. Saper: I move to strike out the witness's construction of the books, that from the looks of the books it struck him very funny; that is a mere conclusion on the part of the witness.

The Master: I think the motion should be granted.

Mr. Bershad: Just striking out that latter part, giving his opinion?

Mr. Saper: Yes.

The Master: I think he could testify whether or not the books were kept in the manner that such books are customarily kept.

Q. Can you state whether the books were kept in the manner that is customary for books of that kind to be kept?

A. The keeping was all right, but it was the very closing entries that were not quite right—that were not complete, as is evidenced by the figures and marks made by the accountant that went over them.

Q. Did you find as of the 15th day of December, 1919, that the purchases and sales were not posted up complete?

A. They were not posted up complete; that was done for a supplementary period by another accountant.

Q. Did those red lines, as you state, indicate that the books had been closed as of the 15th of December?

A. Possibly, yes.

[fol. 63] Q. Can you state, with that in mind, whether the person who closed those books on that date kept the books accurately?

A. I cannot find out if they were accurate without making an audit, but I can safely say that the books were not properly closed as of that day.

Q. The failure to record the sales and the purchases that would indicate that they were not completed as of the 15th of December; that is correct, was it not?

The Master: I don't think that is what you mean.

A. I mean that by not posting the purchases and sales, it was very evident that the person who did that didn't know their business. It is very evident nobody can deny that.

By the Master:

Q. Do you mean that there were entries left out, from the check books that ought to have been in the cash book or ledger, or whatever it was?

A. Absolutely.

Q. Is that what you mean?

A. They were not entered. The sales and purchases from the first to the fifteenth of the month were not entered in the general ledger in the accounts, before the books were closed. That was done some time later by the accountant who went over the books. They were entered in the ledger, purchase and sales account.

Q. You said they were not entered in the general ledger, didn't you?

A. They were not by the original bookkeeper.

[fol. 64] Q. Where were those entries—were they in the cash book?

A. They were in the books of original entry, like the purchase book, the sales book, but they were not summarized up to the 15th of the month. The bookkeeper continued her work as if nothing had happened, when, as a matter of fact, that was the closing time, and she should have totaled up her purchases and sales to the 15th of the month and made her final entries in the ledger, which she didn't do.

By Mr. Bershad:

Q. Do you know what profit the books showed for the year 1919, or rather, what profit was reported for the income tax purposes, as near as you can?

A. The books, as I recollect, showed a profit of something like \$3,000, or a little over.

Q. What was the profit actually earned by Lustgarten, appearing from all his records, whether from the books or other independent records kept by him for that year?

A. The only other method of figuring it would be the tax report. Now, I saw the tax claim in this office filed by the Trustee—paid by the Trustee.

By the Master:

Q. You don't need to testify as to that.

A. I saw the tax bill, which showed the amount of the taxes paid, which is \$1,284.

By Mr. Bershad:

Q. Did you thereafter examine the source of that, and did you check that up to ascertain how much profit there had been for the [fol. 65] year 1919 in the bankrupt's business?

A. I looked at the tax bill, but I couldn't tell from that what that tax was. I went to the collector's office in Brooklyn and I found that that tax was for the year 1919, and that Mr. Lustgarten's personal exemption being \$2,800, I figured the thing backwards to find he must have reported a profit of about \$16,000 to the Government for the year 1919.

Q. On an amended return?

A. Yes, I was informed that an amended return was filed, that the original return was based on this book profit of \$3,000, and the tax paid on that, and an amended return was made later on, evidently six or seven months, and a profit of about \$16,000 was reported, upon which a tax of \$1,284 was paid in 1921.

Q. Is there anything else that you found on the examination of the books that you think is pertinent to the issue here?

A. Well, nothing that I can think of.

By the Master:

Q. What did you say—that the original profit was shown of \$3,000; is that right?

A. Something like that.

Q. And what was the final profit, as you figure it?

A. As I figured it, the final profit, on the basis of the report, was \$16,000.

Q. And the difference between the \$3,000 and the \$6,000 or about \$13,000, would be based upon the failure to enter up the purchases and sales from the first to the fifteenth of December, 1919; is that correct?

A. Part of it would be there.

Q. That is the only error you found?

A. I didn't audit the books. That was the error that was corrected by the accountant for the Receiver; it was corrected in red ink on [fol. 66] the books, but it convinces me of one thing, that the books were incorrect, and that any statement gotten out of the books would be incorrect, and the only way to prepare a correct statement would be to supplement any information that was missing from the books. It is a condition that is often met when incompetent bookkeepers try to close a set of accounts.

By Mr. Bershad:

Q. From your knowledge and experience as an accountant, in order to make up a final closing statement, can you gather all your data for that purpose from your books merely?

A. No.

Q. Must you, in order to complete your closing inventory, go outside of your books for that purpose—yes or no?

A. You must.

Q. What must you do?

A. Explain to the Referee. It is necessary to obtain a true and accurate inventory of the merchandise that you have title to; that does not mean to say only the merchandise that may be right on the floor; it must include merchandise which is out on consignment, for instance, that may be in the hands of contractors; you must include merchandise that may be in the hands of salesmen; you must include merchandise that is out on memorandum to various customers, and also you must include merchandise accounts, including—there is many a time——

By the Master:

Q. Do you mean to say that in a properly kept set of books, there would not be any entries in any of the books showing what the total [fol. 67] inventory was and what was in the hands of contractors and others?

A. No. The inventory must be obtained by a physical count of every item of stock, no matter where kept; it may be in your own hands or in the hands of others, but as long as you have title to those goods, a physical inventory must be made, in order to determine what the cost of the goods sold has been, or there is no way of ascertaining your condition.

By Mr. Bershad:

Q. In items like trimmings, it is not possible to keep an accurate record of the trimmings, which kept fluctuating day by day?

A. It is possible, by running a perpetual inventory system, but the bankrupt did not do that.

Q. Is it customary for a person in that business to keep a perpetual inventory?

A. It is very unusual to have a perpetual inventory.

Q. That would be the only way?

A. That would be the only way to get it from the set of books or from written figures, what your inventory may be; and even that would be only in case it was kept up from day to day, and was accurately kept. Usually you cannot depend on those written inventories; they are not sufficiently accurate.

Q. So that, it would be impossible to actually determine the condition without going outside of the books?

A. You must go outside of the books; you must take a physical count in order to obtain an accurate inventory.

By the Master:

Q. I take it from what you say that it is impossible to verify a financial statement taken from the books of a man in this line of [fol. 68] business, in most cases; is that right?

A. Yes.

By Mr. Bershad:

Q. And that is the only way it can be done, is by physical count of merchandise which constitutes that part of his assets; is that correct?

A. Yes.

Sworn to before me this — day of April, 1922. — — —.

ABRAHAM LUSTGARTEN recalled:

By Mr. Bershad:

Q. Mr. Lustgarten, did you have a customers' memo. book—yes or no?

A. Yes.

Q. What did that record?

A. The merchandise shipped to the customers on approval.

Sworn to before me this — day of April, 1922. — — —

Adjourned to May 5th, 1922, 3 P. M.

Before Hon. Peter B. Olney, Jr., Special Master

Adjourned Hearing on Specifications

New York, May 5th, 1922—3 o'clock p. m.

Present: The Master, Mr. Cohen, Mr. Bershad, Mr. Barrett, Mr. Lustgarten.

[fol. 69] PERCY F. BARRETT recalled:

Examination.

By Mr. Cohen:

Q. Mr. Barrett, in the testimony given at a previous hearing Mr. Wexler testified there was some red ink figures appearing in the books of the bankrupt indicating the accountant for the Receiver had adjusted some differences at the end of the year 1919; did you or any person working with you enter these readjustment figures that appear there in red ink?

A. No, sir.

Q. Did you find these readjustment figures there when you made your audit of these books?

A. I did.

Q. Now, Mr. Barrett, what is the common understanding in book-keeping terms or auditing terms of accounts receivable?

A. Accounts receivable are moneys due from customers due for goods shipped to them.

Q. When merchandise that is out on memorandum or with salesmen or customers on examination would that be included in the ordinary acceptance of the term accounts receivable among book-keepers?

Mr. Bershad: I object, that is not the subject of expert testimony.

Mr. Cohen: My only purpose in offering this testimony is so that the Court may have something to base an opinion when the Court comes to test the credibility of the witness what testified.

The Master: This particular testimony is addressed to the credibility of the testimony of the witness Wexler?

[fol. 70] Mr. Cohen: Not Wexler, but the bankrupt himself when he gave his explanation of these discrepancies between the books and the statement.

The Master: I will admit the testimony for what it is worth.

A. No.

By the Master:

Q. Under what would you classify goods on memorandum or with contractors for work to be done for the bankrupt?

A. It should be included under a proper heading of goods with contractors or it should be included as inventory as it really is inventory.

By Mr. Bershad:

Q. Is it a fact it is the custom among the cloak and suit people, to charge the merchandise to the contractor at a given figure and therefore that given figure when charged to the contractor would be an account receivable?

A. It would not be an account receivable as is generally known by the term account receivable.

Q. So there is a difference between the ordinary acceptance of the words accounts receivable as they are applied by the ordinary merchants and the way they are used by the people engaged in the cloak and suit business?

A. No.

Q. He charges out the goods to the contractor at a profit on his merchandise, is that right, and that is for convenience to prevent stealing?

A. Yes.

[fol. 71] Q. So the merchant treats it as an outstanding account?

A. Not as an account receivable, he treats it as money due from contractors.

Q. Is that not the same thing?

A. No, sir.

Q. You say he treats that as money due from the contractor?

A. Yes, or goods.

Q. He does not treat it as good since he has made a charge, he has made a charge for the contractor for a specific sum greater than the charge to him?

A. Yes.

Q. Doesn't he regard that as an outstanding account?

A. No, sir.

Q. How would any bookkeeper record that?

A. These goods are shipped out to be manufactured and he so records them, he does not expect money for them.

Q. Naturally in the event of a loss then that becomes an account receivable in the event it is not returned?

A. It all depends on his arrangement with the contractor because many of them insure these goods in the hands of the contractor and title does not pass.

By Mr. Cohen:

Q. Now, Mr. Barrett, what was the capital account of Mr. Lustgarten appearing on his books on December 10th, 1918?

Mr. Bershad: I object to that as not within the specifications as filed.

Mr. Cohen: My only purpose in propounding this question is to show the improbability of the explanation given to Mr. Lustgarten that this discrepancy is due to their failure to include certain [fol. 72] merchandise in the inventory and certain so-called out-standings:

The Master: Overruled.

Mr. Bershad: Exception.

A. \$21,688.19.

By the Master:

Q. What did that include?

A. That is his net worth at that time.

Q. You mean some of the assets less the liabilities?

A. Yes, sir.

By Mr. Cohen:

Q. Now, Mr. Barrett, assuming during the year 1918, Mr. Lustgarten made a profit of \$16,000, what should his capital be at the end of 1918?

A. \$37,688.19.

Q. Does there still appear a discrepancy in these figures at the end of the year 1919 when compared with the financial statement in evidence?

Mr. Bershad: I object as there is no proper foundation laid for a comparison between the 1918 and the 1919 figures.

The Master: You may cross examine.

By Mr. Bershad:

Q. You do not mean to contend if his capital account in 1918 showed \$21,000 that because he shows a profit in the year 1919 of \$16,000 that his net worth should have been around \$37,000?

A. Exclusive of drawings.

[fol. 73] Q. That is your contention?

A. Exclusive of drawings, yes.

Q. Did you take into consideration in December, 1919, the market had risen, did you appreciate that fact?

A. Yes.

Q. Did you also appreciate that six months thereafter the merchandise on his shelves some of it became double the value?

A. That does not enter into this at all.

Q. You are eliminating that entirely from your testimony?

A. I am taking only his figures.

Q. You eliminate that entirely?

A. That has already been absorbed in his figures.

By the Master:

Q. How do you mean that?

A. When he arrived at that profit of \$16,000 that takes into consideration any increase or decrease in the value of the merchandise, that was his profit for the year.

Q. In figuring the capital account, the net worth, as of the end of December, 1918, the stock or merchandise in his inventory at the time would be figured at a certain figure?

A. Yes, sir.

Q. In making up the net worth as of December, 1918, the merchandise on hand would have been inventoried and taken at a certain value?

A. Yes.

Q. Now, assuming that he took stock again in 1918 and being cognizant of the change in prices that he took the same amount of merchandise and carried it at a higher figure because of the rise of price, would that have anything to do with the determination of his net worth in December, 1919?

A. That would be included in his operations for the year which, in this case, resulted in a net profit of \$16,000 and the net profit would be transferred to his capital account.

[fol. 74] Q. You are assuming in arriving at the figures of \$16,000 as a net profit, he has taken into consideration the appreciation in the merchandise he had at both dates?

A. It must be handled that way to show his worth, the net result of his operations was a profit of \$16,000 which was shown in his income tax report to the Government.

By Mr. Bershad:

Q. Do you know his report to the Government would not have required him to give that appreciation since he had a right to take his inventory at the market price or purchase price, whichever was lowest, is that correct?

A. They do it that way.

Q. That is correct, is it not, the law permits him to do it and so, therefore, would it not be fair to assume that \$16,000 was outside of the appreciation profit made, including the amount of money the merchandise appreciated from 1918 to 1919?

A. I am not assuming anything. I am only testifying to the profit he reported, I did not assume anything.

By Mr. Cohen:

Q. Mr. Barrett, the capital or surplus as per the financial statement amounted to \$58,135.89; now, assuming that the entries in Mr. Lustgarten's books are correct on December 10th, 1918, and that his then capital was \$21,688.19, what would that indicate his profits were during the year 1919?

Mr. Bershad: I object, no proper basis has been laid for that computation.

[fol. 75] By the Master:

Q. Including in your profits any appreciation he may have given to his stock in trade?

A. \$36,447.70.

Q. That is the difference between the two?

A. Yes, sir.

By Mr. Cohen:

Q. Now, Mr. Barrett, will you please state the total amount of sales during the year 1919 according to Mr. Lustgarten's books?

Mr. Bershad: I object to that as having no bearing on the issues. The Master: Overruled.

Mr. Bershad: Exception.

A. \$173,893.60.

Q. Mr. Barrett, will you please state the total amount of sales during the year 1920 and up to the time of the filing of the petition in bankruptcy?

Mr. Bershad: Same objection.

The Master: Overruled.

Mr. Bershad: Exception.

A. Sales less returns \$91,256.26.

Q. Now, will you please state to the Court what the loss was in operations during the year 1920 and up to the time of the filing of the petition in bankruptcy?

A. We did not have an inventory at the finish, but assuming his goods had been sold at cost——

Mr. Bershad: I object to any assumption.

[fol. 76] Mr. Cohen: I think that is a very fair assumption in view of the fact its gives the bankrupt every benefit we can give him. However, I will withdraw the question. That is the trustee's case.

Mr. Bershad: I think I will rest with the exception I may want the bankrupt's accountants to clarify some of these questions.

Sworn to before me this — day of May, 1922. — — —

Adjourned to May 12th, 1922, 3 P. M.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF
NEW YORK

[Title omitted]

Before Hon. Peter B. Olney, Referee

MINUTES OF FIRST MEETING OF CREDITORS

New York, May 10, 1921—12 o'clock m.

Held at the office of Hon. Peter B. Olney, Referee in Bankruptcy, No. 68 William Street, New York City, pursuant to notice published in the Daily New Record and sent through the mails to creditors. [fol. 77] Appearances: Melville Boyd, Esq., representing Creditors; F. G. Sinclair, Esq., representing the Chatham & Phoenix National Bank; Messrs. Zalkin & Cohen, Attorneys for Creditors and Receiver, Mr. Cohne, of Counsel; Albert Palk, Esq., Attorney for the Corn Exchange Bank, Mr. Mary; Messrs. Lowther & Smith, Attorneys for Bachman & Emmerich, Mr. May of Counsel; Henry H. Kaufman, Esq., Attorney for the American Woolen Company; Abraham H. Cohen, Esq., Attorney for the Bristol Woolen Mills; Abraham Lustgarten, the bankrupt in person.

The Referee: Nominations.

Mr. Boyd: I nominate Mr. Herman Gerdes.

Mr. Cohen: I nominate Mr. Edward J. McGoldrick.

The Referee: What is his address, Mr. Cohen?

Mr. Cohen: 40 Exchange Place.

The Referee: And who do you nominate, Mr. Boyd?

Mr. Boyd: Mr. Gerdes, Herman Gerdes.

The Referee: Now, what is his address?

Mr. Boyd: 225 Fourth Avenue.

The Referee: Who is he?

Mr. Boyd: He is a credit man for Wald & Company.

[fol. 78] The Referee: How many claims have you, Mr. Boyd.

Mr. Boyd: Twenty-two claims, aggregating about \$22,000.

The Referee: File those claims, please.

Mr. Boyd: I will file these claims.

The Referee: Whom do you vote for, Mr. Kaufman?

Mr. Kaufman: I suggest an appointment of three trustees in this case so that there won't be any criticisms. I have just suggested that Mr. Gerdes and Mr. Boyd—

The Referee: Mr. Cohen—

Mr. Cohen: I don't see why that is necessary at all.

Mr. Boyd: I think that three trustees would be rather cumbersome.

The Referee: That is the general experience.

Mr. Boyd: It is the consensus of opinion Mr. Gerdes is an able and energetic man.

The Referee: How many claims have you, Mr. Cohen?

Mr. Cohen: Oh, I haven't got enough to swing the situation. You have passed your vote for Mr. Gerdes. If the gentleman don't see fit to cancel the suggestion I simply withdraw Mr. Gerdes' nomination.

The Referee: Now, the only question about the amount of the bond—what has Mr. McGoldrick on hand, do you know, Mr. Cohen?

Mr. Cohen: He has \$6,800 in cash on hand and the merchandise in his place of business is roughly \$5,000 and there are some outstanding accounts. Now, they place the outstanding accounts at \$10,000. I think a \$15,000 bond would be ample.

[fol. 79] Mr. Kaufman: I think a \$10,000 bond would be enough.

The Referee: What do the creditors say about that?

(Voices of Creditors:) \$10,000.

Mr. Cohen: Mr. Kaufman, the attorney for the bankrupt telephoned a few minutes ago and says he is engaged in a trial up there; the bankrupt is here, but I don't think there is any sense of putting any questions to him.

The Referee: When do you want this to go over to, how about the 18th, or the 19th, which is best?

Mr. Cohen: The Receiver has an order for a sale, but we have been told about an offer of composition—

The Referee: The bankrupt ought to know something about his affairs—do you propose to put through a settlement?

Mr. Lustgarten: I don't hear you.

The Referee: Do you expect to make a settlement?

Mr. Lustgarten: I can't hear a word.

The Referee: Will you write it out, Mr. Stenographer?

(Question written out by the stenographer.)

Mr. Lustgarten: My lawyer will explain you everything.

(The Referee administ-ed the oath, first having the oath written out and having the bankrupt read it.)

Adjourned to May 19, 1921, 2 P. M.

[fol. 80]

New York, May 19, 1921—2 o'clock p. m.

Before Hon. Peter B. Olney, Referee

Adojurned First Meeting

Appearances: Messrs. Zalkin & Cohen, Attorneys for the Trustee, Mr. Cohen, of Counsel; Herman G. Gerdes, Esq., Trustee in Person; The Bankrupt, in Person.

ABRAHAM LUSTGARTEN, the bankrupt, having been previously duly sworn, testified as follows:

Direct examination.

By Mr. Cohen:

(The witness, being deaf, counsel wrote the questions on a piece of paper and submitted them to the witness.)

Q. Is your lawyer going to be here, is Mr. Berchand going to be here?

A. I don't hear you what you say.

Q. Where is your lawyer?

A. He is not going to be here.

Q. Where do you live?

A. I told you he could not attend the meeting today. 217 North Atlantic Avenue, Arverne, Long Island.

Q. Where does your bookkeeper live?

A. I don't know.

[fol. 81] Q. Was your bookkeeper Miss Sanders?

A. The girl was there about ten days?

Q. Is this her address (indicating)?

A. I don't know her address; I suppose that's the right address.

Q. Who was your bookkeeper before Miss Sanders?

A. I had a certain young lady, she used to live in Coney Island and I don't know her name.

Q. Where does Louis Lustgarten live?

A. 217 North—14 West 117th Street.

Q. New York?

A. New York.

Q. How long did Louis work for you?

A. About twelve years, about ten or twelve years.

Q. How old is Louis?

A. I don't know.

Q. About?

A. About twenty-four, twenty-five years old, probably more.

Q. Where does he work now?

A. I don't know.

Q. Is he a married man?

A. He is getting married pretty soon, he is got engaged.

Q. And whom does he live with now?

A. His parents.

Q. What work did Louis do for you?

A. Inside and selling.

Q. Did he help with the books?

A. No.

Q. Who last worked for you outside of Louis and Miss Sanders?

A. I had a few salesmen.

Q. What are the salesmen's names and addresses?

A. One name I remember was Siegel, the other one I don't remember, I don't know their addresses.

Q. Where does Siegel work now?

A. I don't know where he works. Mister, you will have to postpone it, it is impossible. I am not feeling well, I told Mr. Berchand; he told me I can't be examined today; I got terrible pains [fol. 82] in my head, all full of buzzing, I can't get together my thoughts and know what I am talking about.

Q. Have you any money put away in the bank?

A. No.

Q. What is your wife's name?

A. Tillie Lustgarten.

Q. Have you any children, please state their names, ages, and places of residence?

A. I got three children, Felix Lustgarten, eight years old; Helen L., seven years; Hilda, six and a half years—I mean five and a half years.

Q. Did you give your wife any moneys to keep for you before the bankruptcy proceedings were begun against you?

A. No.

Q. Has your wife a bank account?

A. No.

Q. Did she ever have a bank account?

A. I don't know, that I can't tell you.

Q. You drew over \$7,000 from your business in November and December, 1920, and January and February, 1921, what did you do with this money?

A. I can't give you any figures at all, I don't remember anything about figures at all.

Q. Did you draw so much money during those months?

A. I can't give you any names and figures at all, I don't remember any figures at all, I have no idea about the books, about the drawings at all.

Q. When did you stop manufacturing?

A. I don't remember what year it was, about two years, I think.

Q. What were these payments for, I pointed out to you on the accountant's report, cash disbursements charged to labor account, December, \$2,562?

A. I can't tell you about those figures, whether they was charged in the right place or not.

[fol. 83] Q. Who is supporting you and your family now?

A. What is that?

Q. Supporting?

A. I am lending some money.

Q. From whom do you loan money?

A. Some of my friends.

Q. Give me their names and addresses?

A. That is person- affairs, I can't give you, I am taking from a sister, I am loaning four, five hundred or a thousand dollars, I can't give you the name.

Q. What is your sister's name and address?

A. I have so many sisters, I don't — which one to give you the name of, I got seven sisters.

Q. Give me the name and address of the sister from whom you borrowed money?

A. One sister lives across the street from me in the same block, two sisters live there.

Q. Their names?

A. Names?

Q. Yes?

A. One Mollie Lustgarten, one is Jennie Lustgarten.

Q. How much money did Mollie loan to you?

A. I couldn't tell you that, that's private affairs, I can't tell you that.

Mr. Cohen: There is nothing private in this Court; if you don't answer the questions you cannot get a discharge in bankruptcy.

The Witness: This is a private affair, I told you that. I am telling you as much as I know, as much as I can answer.

The Referee: That is not so, that won't do. You can tell him if he don't answer proper questions then I should have to certify to the District Court he was in contempt and they would arrest him and bring him up to Court to know why he didn't answer, and, [fol. 84] after hearing him, if he didn't answer or there was no excuse for answering, they would lock him up. Now, is the last question a proper one?

Mr. Cohen: I think it is.

The Referee: Read it, Mr. Stenographer.

(Record repeated by stenographer.)

The Referee: Now, can anybody make him hear, can you hear me? And they say that no people are so deaf as those who won't hear. Did you ever hear that expression?

The Witness: I didn't hear you.

By the Referee:

Q. None so deaf as those who won't hear, who don't want to?

A. I don't hear you.

The Referee: What was the last question?

Record repeated by stenographer.

The Referee: Well, that manifestly is not so, if he borrowed money from his sisters, he knows approximately how much it is. You have to answer it. You ought to answer that question. What is the question?

Mr. Cohen: As to how much.

The Referee: Put the question in that shape.

Q. How much did you borrow from your sister?

The Referee: When did he say this was?

Mr. Cohen: He is being supported now, he says, by moneys he borrowed; there is a big discrepancy in his affairs as indicated by [fol. 85] an accountant's report, a discrepancy that runs into many thousands of dollars, there is a discrepancy in the merchandise account alone—

The Referee: Has he any attorney?

Mr. Cohen: He has an attorney, Mr. Berchand and Mr. Berchand called me up——

The Referee: Where is he?

Mr. Cohen: He told me he was not going to bother coming, he said he could not see that we could make any headway one way or the other.

The Referee: Well, I think that the question is proper and that the witness should answer it and I will instruct him to answer it on the record; if he don't answer it, I don't see what you can do, except to go on with something else.

Mr. Cohen: Mr. Referee, while your mind is on this case, Mr. Gerdes is the Trustee, and I represent him as counsel. The Receiver has spent a considerable amount of money under an order of the Court to get an accountant's report, but we were limited to the extent of about \$250. It appears from the recommendation of this accountant that there ought to be a further investigation about all the merchandise discrepancies. In submitting his report, he makes this statement: "Before final settlement is made, I recommend that a full and detailed investigation be made of merchandise purchases, the receipt of goods and sales from October 31st, 1920 to February 28, 1921, and a comparison made of inventory of piece goods and finished goods on hand at February 28, 1921." The reason he makes this suggestion is that there is such a large discrepancy in the amount of [fol. 86] merchandise which he had on hand and which he purchased during a given period, and which is not accounted for by his books and by the merchandise on hand at the present time. On account of his alleged physical condition, we cannot see any way we can get at this information except through the help of an accountant, and for that reason I want to ask leave of the Court to permit the Trustee to incur an additional expense in making this investigation; there is a considerable estate here——

The Referee: Well, you want to put that in the form of a petition so as to state the facts, and you ought to state also how much you have paid already for the accountant's services.

Mr. Cohen: All right, sir, I will submit it in the form of a petition.

The Referee: And why — you think it would be wise to do it. Didn't he have a bookkeeper?

Mr. Cohen: He did have a bookkeeper, but it seems strange that the young lady was his bookkeeper for only about two weeks before the bankruptcy intervened and I——

The Referee: Who was the bookkeeper before that?

Mr. Cohen: I have not been able to find out who the bookkeeper was before that.

The Referee: Did you ask him?

Mr. Cohen: Yes, he said he don't know. Now, I will subpoena this last bookkeeper and see whether I can get any information from her, and I will also subpoena some of his former employees, one employee [fol. 87] in particular, a relative of his, and I may get some information here.

The Referee: You see, if it is a fact that this man does not hear anything, while it is a very difficult thing to know what to do with him——

Mr. Cohen: It is a most difficult case to handle.

The Referee: I don't think he even heard me then, because he did not even wink an eyelash.

Mr. Cohen: I do not doubt but that there is something the matter with him.

Mr. Gerdes: The bank tells me that he was slightly deaf, but they had no difficulty in making him hear what they wanted to.

Mr. Cohen: I will present that question to him again and present my application to your Honor for leave to employ an accountant.

The Referee: Yes.

Discussion between counsel and the Referee.

By Mr. Cohen:

Q. Give me the names of all the bookkeepers you have had in your business and tell me where they livê?

A. I never knowed the names and addresses, and they have told me the names and addresses, I can't hear, I could not get the names right.

Q. How long have you been deaf?

A. July going to be four years.

Q. The judge says you must answer the question, so you must tell me how much money Mollie gave you?

A. I can't tell you exactly, I can't remember, one gave me \$50, another one gave me \$50, another seventy-five and I got twenty-five and another gave me seventy-five, that's how I live now.

[fol. 88] The Referee: The substance is that from time to time he got from fifty to seventy-five dollars from these people, that is a substantial answer.

Mr. Cohen: Yes.

The Referee: Do you think he did not get it from them?

Mr. Cohen: Well, if my theory is correct, this story may be a fabrication.

Q. Have you been working for anybody since you are bankrupt?

A. No.

Q. Have you earned any money since the bankruptcy?

A. No.

Q. Does your wife work and earn any money?

A. No.

Q. Do you own the house in which you live?

A. No, sir.

Q. Does your wife own it?

A. No.

Q. Whom do you pay rent to and how much?

A. \$1,100 a year, to Mr. Murray.

Q. Did you pay last month's rent to Mr. Murray?

A. This rent was paid for in four payments, it was paid off till February—till November 1st, is paid off, they don't pay them by the month there, they pay them in four installments.

Q. When did you pay the last installment?

A. Some time in February.

Q. What is Mr. Murray's address?

A. He lives on the same block, I can't tell exactly what his address is. Do you mean the landlord's? Probably about 221 or 223, on the same block.

Sworn to before me this — day of May, 1921. — — —

Adjourned to June 2, 1921, 3 P. M.

[fol. 89]

New York, June 2nd, 1921—3 o'clock p. m.

Before Hon. Peter B. Olney, Referee

Adjourned First Meeting

Appearances: Messrs. Zalkin & Cohen, Attorneys for the Trustee, by Mr. Cohen, of Counsel; Shirley Sandler, a witness.

SHIRLEY SANDLER, called as a witness by counsel for the Trustee, having been first duly sworn, testified as follows:

Direct examination.

By Mr. Cohen:

Q. Where do you live?

A. 221 East 121st Street.

Q. With whom do you reside at that address?

A. My parents.

Q. Do you know Abraham Lustgarten?

A. From working with him.

Q. How long did you work for him?

A. About three weeks.

Q. When did you commence to work for him and when did you quit working for him?

A. I can't remember the exact date.

Q. Were you in his employ when the bankruptcy proceedings were commenced against him?

A. Yes, sir.

Q. Do you remember the Receiver coming into the place?

A. Yes.

Q. Do you remember the day when the Receiver came into the place?

A. I don't.

[fol. 90] Q. Do you remember assisting Mr. Lustgarten to get certain paper?

A. Yes.

Q. And you gave him certain information?

A. Yes.

Q. How long have you been a bookkeeper?

A. About five years.

Q. Before you worked for Lustgarten where were you employed?

A. L. Wohl & Co., 395 Fourth Avenue.

Q. How did you happen to get a position with Mr. Lustgarten?

A. Through an agency.

Q. Had he advertised?

A. He had advertised, I understand, and then this agency had written to me and that is how I got the position.

Q. Now, when you came to his place of business the first time did you find any bookkeeper there?

A. No, she had left.

Q. Do you know who his bookkeeper was before you?

A. No, I don't.

Q. Did you ever see her?

A. No.

Q. Did you ever hear of her name?

A. No.

Q. Who was employed by Mr. Lustgarten besides yourself at his place of business at 149 West 26th Street during the three weeks that you were there?

A. Louis Lustgarten.

Q. What were his duties?

A. Oh, he was a sort of general manager and salesman, he took care of the entire place.

Q. Are there any other employees besides you and Louis Lustgarten?

A. No, there was a salesman, only one that I know of, a commission salesman.

Q. Was he in the place of business constantly?

A. Why, I never saw him.

Q. What was the name of this salesman?

A. I don't remember.

[fol. 91] Q. Now, when you came to the place of business were the books kept regularly?

A. No, he was supposed to give me a new set of books; that was the only condition that I started to work there, the books were jumbled horrible.

Q. Did you make very many entries in the books during the three weeks that you were there?

A. Very little, I just made up the few charges, that was all.

Q. Now, what charges did you make; for merchandise going out?

A. Yes.

Q. Who had charge of the shipping?

A. Louis Lustgarten.

- Q. And how would you know that merchandise went out?
 A. By the charges that I made.
 Q. And who gave you the information to make the charge?
 A. Louis Lustgarten.
 Q. Aid did you ever know of Louis Lustgarten sending out merchandise without instructing you to make the charge?
 A. Never.
 Q. Do you mean you don't know if he did?
 A. The charge was made and given to me.
 Q. Did you have any difficulty in getting along with Mr. Abraham Lustgarten on account of his deafness?
 A. Yes, sir.
 Q. Could you make yourself heard by him?
 A. Yes, sir.
 Q. He understood what you said when you spoke to him?
 A. Yes, sir.
 Q. Did you ever find it necessary to put your remarks down in writing?
 A. Once in a while; according to the weather.
 Q. Did you ever notice anything else wrong with him outside of the fact that he was deaf?
 A. Outside of the fact that he was very nervous.
 [fol. 92] Q. Did he ever give you instructions to make any entries in the books?
 A. Yes.
 Q. What instructions, for instance?
 A. Well, notes that came payable and well—certain bills would become payable.
 Q. Did Mr. Lustgarten do any manufacturing in his place of business?
 A. Not while I was there.
 Q. Well, he didn't have the plant for manufacturing in his place of business, did he?
 A. Nothing, only jobbing.
 Q. Do you know whether he sent out any merchandise to be manufactured?
 A. Well, he had contractors.
 Q. Do you know who the contractors were?
 A. I am not sure, but all I know one was Berger. While I was there lots was coming in, but nothing was taken out.
 Q. Wasn't any merchandise taken out during that time to contractors—
 A. Nothing at all.
 Q. Did you ever have a book in which you entered merchandise sent out to contractors?
 A. I saw a book, but I never made any entries in it.
 Q. Who was supposed to have charge of that merchandise?
 A. Louis Lustgarten.
 Q. Was there a cutting table there?
 A. There was.
 Q. Have you ever seen a cutter working there?

A. Never.

Q. Did you understand under what condition the merchandise went out to contractors?

A. Well, in piece goods.

Q. Never cut up?

A. Never cut up, that I know. The time I got there he had just moved into the place.

Q. Was it during the month of February of this year that you worked for Lustgarten?

A. Yes.

[fol. 93] Q. Are you employed at the present time, Miss Sandler?

A. I am.

Sworn to before me this — day of —, 1921. — — —.

Adjourned to June 8th, 1921, 11 A. M.

Before Hon. Peter B. Onley, Referee

Adjourned First Meeting

New York, August 11, 1921—10 o'clock a. m.

Present: The Referee, Mr. Cohen, Mr. Bershad, The Bankrupt, in Person.

(The witness, being deaf, the questions were propounded in writing.)

ABRAHAM LUSTGARTEN, recalled:

Direct examination.

By Mr. Cohen (continued):

Q. Mr. Lustgarten, did you keep books in your business?

A. Yes.

Q. Are you familiar with the books that were kept?

A. Very little.

Q. Did you instruct your various bookkeepers what entries to make in those books?

[fol. 94] A. I instructed them to pay bills, notes, post the bills when they came in.

Q. Did you ever have an accountant go over the books for you?

A. About five, six years ago; since then I hadn't had any.

Q. How do you know if your bookkeeper was keeping the books correctly?

A. I never knew that.

Q. Did you ever examine the entries in the books that your book-keeper was making?

A. Never did.

Mr. Cohen: Will you please mark this book.

Book referred to received in evidence and marked "Trustee's Exhibit 1, August 11, 1921."

Q. I show you book which the stenographer has marked Exhibit 1, please state what that book is?

A. Check book.

Mr. Cohen: Will you mark this one.

Book referred to received in evidence and marked "Trustee's Exhibit 2, August 11, 1921."

Q. I show you a book which the stenographer has marked Exhibit 3, please state what that book is?

A. I don't know what they call that book.

Mr. Bershad: It looks like a ledger, I think.

Q. Look over this book, Exhibit 3, carefully.

A. I looked, but I don't know the name of the book, what they call that book; I don't know exactly what the book is supposed to be called.

[fol. 95] Q. See page 5, with the name Max Berger & Co., what business did you do with Max Berger?

A. He was manufacturing for me, coats and suits.

Q. See page 15, Wolinsky & Schwartz?

A. This made for me coats and suits, too.

Q. See page 16, 17, S. B. S. Co. and W. B. Dress Co.?

A. This also made dresses.

Q. Look at all the other names in the book, don't that show that this was contractors' account book or ledger?

A. I presume it is sub-manufacturers' book, not a contractors' book.

Mr. Cohen: Mark this, please.

Book referred to received in evidence and marked "Trustee's Exhibit 4, August 11, 1921."

Q. I show you a book which the stenographer has marked Exhibit 4, please state what that book is?

A. According to what it is marked outside on the page, General Ledger.

Q. Look inside.

Mr. Bershad: Complete your question.

A. That must be a general expense ledger, something like that, commission sales.

Mr. Cohen: Mark this book, please.

Book referred to received in evidence and marked "Trustee's Exhibit 5, August 11, 1921."

Q. I show you a book which the stenographer has marked Exhibit 5, please state what that book is?

A. I don't know what that book is called—a sales book, sales [fol. 96] commission book, here, where I find these names here.

Mr. Cohen: Mark that one.

Book referred to received in evidence and marked "Trustee's Exhibit 6, August 11, 1921."

Q. I show you a book which the stenographer has marked Exhibit 6, please state what that book is?

A. Whatever it is marked outside, it's a cash book.

Q. Did you keep a petty cash book?

A. No.

Q. Did you keep a payroll book?

A. I kept a petty cash slip system.

Q. Did you keep a payroll book?

A. Yes.

Q. Where is that payroll book?

A. It remained in the place.

Q. When did you see the payroll book, last time?

A. I never seen that payroll book.

Mr. Bershad: Wait a minute, let me get that question for him.

By Mr. Bershad:

Q. You are asked, when did you see it last time?

A. I couldn't remember since a year or two ago, I never went over the safe and looked at the books.

By Mr. Cohen:

Q. What became of the slips for the payroll?

A. They remained in the place of business.

Q. Between December 11th and December 22nd, 1920, there is charged to labor account in your books \$2,562, to whom was this money paid?

A. To contractors.

[fol. 97] Q. Who were the contractors?

A. By the name of Joe Patchef.

Q. What is his address?

A. I don't know his address, he had his place of business in Brooklyn.

Q. Where in Brooklyn?

A. I think he told me—I don't remember, I think in Flatbush Avenue.

By Mr. Bershad:

Q. How did you get him?

A. Through advertisement.

Q. You advertised?

A. I advertised in the New York Times for contractors.

Q. And he came in answer to one of the ads.?

A. He came in answer to my ad.

By Mr. Cohen:

Q. Is his name in the contractors' or manufacturers' book?

Mr. Bershad: If he knows.

A. I don't know what book he is in, I presume he is in the payroll book, he wasn't a sub-manufacturer, he was a contractor.

Q. Will you please show me in your books where there were charges made, either to labor or petty cash, before November 18, 1920; your bookkeeper, Miss Sandler, says that the charges which were made to labor and to petty cash should have been charged to office and shipping salaries?

A. If I would know bookkeeping, I would show you. Miss Sandler, I don't think she knew what she was talking about, she was the end of February there, I started paying labor about the middle of January.

[fol. 98] By Mr. Bershad:

Q. How long was she with you?

A. About two or three weeks, the end of February.

By Mr. Cohen:

Q. According to your books, the cash disbursements between November 1, 1920, and February 28, 1921, amounted to \$11,706; the items comprising this amount are charged to labor account, petty cash, and to office and shipping salaries; according to your books, all you paid to Miss Sandler and to Louis Lustgarten, your nephew, was \$1,054, this left a balance of \$10,652; what happened to this balance?

A. Every check that was drawn is made a record in the cash—in the check book, the stub of the check book for what purposes and who got the money.

Q. Look at Exhibit 2, check No. 15,336, payroll \$225, where does it show on the stub who received this money?

A. It says payroll, marked payroll, from this I suppose was posted in the other books.

Mr. Cohen indicates to the witness entry in exhibit, page 45, under date of February 25th, payroll \$225.

The Witness: \$225 was payroll for the inside help, myself and the inside help.

Q. Please name the inside help to whom you paid this \$225, and how much to each one?

A. Louis Lustgarten, the bookkeeper, and myself, and the last two weeks in February or three weeks in February I didn't had any help, the last man left me the first week in February.

[fol. 99] Q. (Counsel indicates question again.)

A. The bookkeeper and my nephew and myself.

Q. (Question indicated again.)

A. Louis Lustgarten got \$40, and the bookkeeper got \$23. \$100 a week I give my wife, \$62 I got, my spending money.

Q. I show you check 15,337, "Expenses, \$1,000," what was that for?

A. \$300 I gave Mr. Bershad, \$275 I got rent, \$60 about I paid my housekeeper, I paid a man for coals \$64, I paid my wife's bills, doctor's bills, that's how all the thousand was spent.

Q. I show you check 15,330, payroll \$225?

A. That's for the week before.

Q. How was that paid out?

A. The same, \$225, the same thing as the week before, my nephew and the bookkeeper and myself and my wife.

Q. Check, February 5th, \$160?

A. Was paid to the bookkeeper and my nephew, and I had a shipping boy there, this \$160 was paid to my nephew, the boy I had there and Louis Lustgarten and my wife, the same day.

Q. Check No. 15,317, general expenses \$150?

A. Moving expenses.

Q. Check 15,316, payroll \$375?

A. January 29th I had about — salesmen to pay out, shipping boy and the bookkeeper, my nephew, myself and my wife, that's all.

Q. According to your books, in the year 1917 you drew only \$1,455.78; in 1918, \$3,911.69; in 1919, \$3,838.56; 1920, up to October 31, 1920, you drew \$3,614.42, and from November 1, 1920, to your bankruptcy, you withdrew \$5,939.03, will you please explain why, in the period of four months you withdrew so great an amount immediately prior to your bankruptcy?

A. Maybe, it's right, I don't believe it, I don't believe if its right.

[fol. 100] By Mr. Bershad:

Q. What are you talking about?

A. This \$146 here, how can a man live on \$1,400 a year?

Q. You mean in 1917?

A. Twenty-five dollars my pocket money at that time? How can I live on \$1,400, Mr. Bershad, \$25.00 a week?

Q. (Question shown witness again.)

A. I never drew \$5,939 for myself.

Mr. Bershad: His answer is that that money that appears to have been drawn was used for labor and contractors and for the conduct of the business and for moving.

By Mr. Cohen:

Q. What did you do with cash amounting to \$11,706, which you withdrew from this business from November 1, 1920, to February 28, 1921?

Mr. Bershad: You better reframe that question.

Mr. Cohen: Let him answer it the best way he can.

By Mr. Bershad:

Q. Did you ever draw that for yourself?

A. November, my books shows—the books shows what this money was spent for, I never drew \$11,706 to my account.

Q. It was drawn for the conduct of the business and for contractors?

A. It was drawn for the conduct of the business and to contractors.

[fol. 101] Mr. Cohen: Witness is shown a report of Louis C. Goetting, dated March 17, 1921, at page 2, under heading of "Cash Disbursements," amounting to \$11,706.

Mr. Bershad: What is the question, Mr. Cohen?

The Witness: The books shows what it is for, whatever is charged to labor was charged to labor, what is charged petty cash is charged petty cash.

By Mr. Cohen:

Q. Does this seem to be correct?

Mr. Bershad: What does he know about that?

A. I can't tell whether they are correct or not, probably it was not posted to the right place, you know what I mean, probably it was supposed to be posted to labor and was posted to office, probably it was supposed to be posted to office and charged to labor, this I never knew, whether it was kept right or not.

Q. Is it possible that from November 1, 1920, to February 28, 1921, you drew \$7,859 for office and shipping?

A. It wasn't charged right, it was supposed to be charged to labor.

By Mr. Bershad:

Q. That was during the strike period and Patchef was working for you, your contractor; was he doing work for you?

A. There was no strike in the cloak business since three years [fol. 102] ago, but this contractor done work for me since October till the end of January.

Q. 1920 to 1921?

A. Yes.

By Mr. Cohen:

Q. Wasn't your labor charged to manufacturing and contractors?

A. This one, the book what we seen before is sub-manufacturers: the other man done work for me as a contractor, this is what we call indirect labor, these people they manufacture for jobbers and they manufacture on their own hook.

Q. Who were your contractors between November 1, 1920, and February 28, 1921?

A. Joe Patchef.

Q. Why is there a special charge to labor December 11th, 14th and 22nd, \$2,562?

A. There is no special charge.

By Mr. Bershad:

Q. The goods that Patchef made up for you, and for which you paid him from the items of labor appearing, did you have a good part of them in your place when the Receiver took charge of your factory?

A. A good many of these garments was in the place and a good many was sold during the time.

By Mr. Cohen:

Q. Is Louis Lustgarten your nephew?

A. Yes.

Q. When did you first employ him?

A. About nine or ten years ago.

Q. Did he have a written contract with you?

A. Verbal contract.

[fol. 103] Q. What were the terms of his employment by you?

A. During 1919 he was getting fifty dollars a week, he drew thirty and twenty remained for saving purposes; during 1920 he was getting sixty dollars a week; he drew forty and twenty remained for saving purposes; I told him, "Any time you will need your money you can have it, if it is a good cause, I will give it to you;" during the month of December, 1920, he got engaged; he asked me — I should give him the money, and I gave it to him.

Q. Why doesn't the name of Louis Lustgarten appear in the salesman's commission book?

A. The only amounts that appear in the salesman's commission book that is that work for commission only; he wasn't a commission man, he was a salaried man.

Q. Have you any entry in any book of an account with Louis Lustgarten?

A. It must be some entry when they got out the Two thousand dollars; it must be entered in some book.

Mr. Cohen: I will close the first meeting.

Sworn to before me this — day of August, 1921. — — —

Peter B. Olney, Referee.

Hearing closed.

[fol. 104] EVIDENCE: TRUSTEE'S EXHIBIT 1—May 17, 1922

Statement of Financial Condition

Name, Abraham Lustgarten.
 Business, Mfg. Coats, Suits.
 Address, 8-10 West 19th Street.

For the purpose of obtaining loans from the Corn Exchange Bank, of New York City, I the undersigned, namely Abraham Lustgarten, make the following statement of my financial condition, and represent that the said statement is true and correct of my own knowledge, and that it truthfully sets forth all my assets on the 15th day of Dec. 1919, and all my liabilities of every kind and nature whatsoever, for which I the undersigned, was obligated directly or indirectly on said date and Abraham Lustgarten, the undersigned make (s) such statement after a personal examination of the merchandise on hand on said date as well as the books maintained and kept by me in the regular course and conduct of my business, which books show all of the transactions on which the following statement is based.

This statement is to be regarded by Abraham Lustgarten and by The Corn Exchange Bank as continuous and binding, and to form a true statement as to the assets and liabilities of the undersigned, and other matters, to be relied upon by the Corn Exchange Bank upon application by the undersigned, for all loans until another statement in writing shall be substituted for this, or this statement recalled.

[fol. 105]

Assets

Merchandise on hand (@ cost)	\$39,004.97
Accounts outstanding, due from customers, all good...	30,642.50
Other accounts outstanding, all good	None
Bills receivable	None
Cash on hand	945.63
Cash in the following banks:	
Corn Exchange	6,319.31
Chatham & Phoenix	2,723.48
Fixtures, present value	1,500.00
Real Estate, assessed value	None
Total assets	\$81,135.89

Liabilities

For merchandise on open acct	\$3,000.00
Borrowed from banks	20,000.00
Total liabilities	\$23,000.00

Net worth is at least \$58,135.89.

I have not pledged, hypothecated or assigned any outstanding accounts or merchandises, or mortgaged any merchandise, stock or fixtures as security for loans or advances, or for any other purpose.

— contingent liabilities are:

Accommodation endorsements.....
Bills receivable under discount.....
Surety on bonds or undertakings.....
All other contingent liabilities.....
Contingent liabilities of individual partners not included above.....

None

Amount of sales of my business for the year ending the 15th day of Dec. 1919, were.....	\$175,000.00
I carry fire insurance policies in the amount of.....	42,000.00

[fol. 106] I have other bank ac-ounts at Chatham & Phœnix.

At the date of signing this statement my capital is not less than as above stated. And it is hereby agreed that in the event that at any time The Corn Exchange Bank shall find the foregoing statement untrue in any particular, or in case of the failure or insolvency of the undersigned, or in case a petition in bankruptcy be filed by or against the undersigned, or a judgment be recovered against the undersigned in a court of record, or upon pledge and transfer of accounts receivable by the undersigned, or a general assignment be made by the undersigned for the benefit of creditors, or in case at any time the net worth of the undersigned is substantially less than as above stated, all loans and obligations of the undersigned held by the said bank shall become immediately due and payable. And further, whenever my financial condition is changed materially from the financial condition shown in the above statement, I agree to notify the said bank at once of such change, whether applications for further loans are made or not. And it is further agreed that, upon failure to notify said bank as aforesaid, or in the event of such change in financial condition, all loans and obligations of the undersigned held by the said bank shall at its option, become immediately due and payable.

Dated, Jan. 5, 1920.

Abraham Lustgarten. Witness: Hyman Josephson.

This statement was delivered to The Corn Exchange Bank, Fifth Avenue Branch, by Mr. Josephson, representing Abraham Lustgarten and was received by C. A. Ingalls.

Date, 1/6/20; Hour, 1:15 P. M.

In the Matter of LUSTGARTEN

The recent case of B. & L. Glove Corp., is not to be interpreted (in my judgment) as holding that mere lapse of time take away all right to rely upon a borrower's or buyer's financial statement.

It does hold that a man cannot under all circumstances and for any period of time continue to rely upon such a piece of paper.

The determining issue in the Glove Co. case was the proven financial condition of the business community at the time then in question. Thus, the questions are of fact, and are, did the creditor actually rely on the financial statement, and, under the circumstances, shown, did he have a right so to rely?

In my judgment, if a man gives to a Bank from whom he regularly borrows, a statement which contains (as the commissioner finds this one did) that it was a continuing statement and that the borrowee would notify the Bank at once of any material changes in his exhibited financial condition,—upon such a statement, the Bank has a right to rely until such notice is given. That is the very bargain between the borrower and lender.

I am, therefore, compelled to disagree with the Commissioner in respect of a matter of financial statement.

But further I am of opinion that the specification alleging failure to keep proper books are upheld.

The bankrupt maintains that he really owed shortly before his failure, \$2,000 to his nephew, who had been in his employment. [fol. 108] Such a debt was by no means trifling considering the extent of this bankrupt's business and his available assets. The existence of the debt made a material difference in his net assets.

No trace of the debt is found in his books, and no excuse is given for such omission.

There was a failure to keep proper books and the intent necessary by the statute is one of reasonable inference.

The appropriate provision of law is "intended to insure the keeping of correct and complete accounts (and) should be rigidly enforced" (re Hanna, 168 Fed., 238). The case cited by the creditors In re Kollie, 22 A. B. R., 515, is apposite.

Let a discharge be denied.

Sept. 22, 1922.

C. M. Hough, C. J.

[fol. 109] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT
OF NEW YORK

[Title omitted]

ASSIGNMENT OF ERRORS

Now, on this 13th day of October, 1922, comes Abraham Lustgarten, Bankrupt herein, by his attorney, Laurence J. Bershad, and says that the order, judgment or decree dated October 6th, 1922, in this proceeding, denying the Bankrupt herein his discharge, and failing to confirm the report of Special Commissioner Hon. Peter B. Olney, Jr., is erroneous and against the just right of the said Abraham Lustgarten, for the following reason:

First. That the Court erred in denying the Bankrupt herein his application for a discharge.

Second. That the Court erred in reversing the findings and conclusions of the Special Commissioner on the questions of fact found by the said Special Commission, viz: That the objecting creditor relied on the financial statement of Abraham Lustgarten as of inventory of December 15th, 1919, and that the Court erred in finding as a question of fact that the said statement as of December 15th, 1919, was false, and was given by the Bankrupt to the objecting [fol. 110] creditor for the purpose of obtaining credit thereon, and that the Court erred in finding as a question of fact that the objecting creditor did as a matter of fact rely upon the said financial statement in extending credit to the Bankrupt herein, and that the Court erred in finding as a question of fact that the payments to Louis Lustgarten were fraudulent transfers.

Third. That the Court erred in reversing the conclusions and findings of the Special Commission in that the objecting creditor has failed to establish all the specifications of objection as filed, in that the Bankrupt herein has failed to keep proper books of account, with the fraudulent intent to conceal his true condition from his creditors.

Fourth. That the said Court erred in reversing the findings of the Referee on the questions that the Bankrupt who was physically infirm, did not have any control over, nor did he himself keep the records in his books of account.

Fifth. That the Court erred on the question of fact that the said records and books of the Bankrupt were kept by the employees of the Bankrupt with whom the Bankrupt was unable by reason of his physical infirmity to keep in touch, and over whom he therefore did not have the control that was necessary to establish the intent to conceal his true financial condition, or to suppress same from his creditors.

Sixth. That the Court erred in failing to confirm the report of the Special Commissioner recommending the discharge of the Bankrupt herein.

[fol. 111] That the said Abraham Lustgarten prays that the said judgment, decree or order may be reversed and that the report of the Special Commissioner be sustained and confirmed; that the Court will allow an appeal herein from said judgment, decree or order and will approve the bonds for the stay of all proceedings under the order appealed from, extending such appeal and your petitioner will ever pray, etc.

(Sgd.) Abraham Lustgarten. Laurence J. Bershad, Attorney
for Abraham Lustgarten, Bankrupt.

UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW
YORK

[Title omitted]

NOTICE OF APPEAL

SIR:

Please take notice that Abraham Lustgarten, the Bankrupt herein, hereby appeals to the United States Circuit Court of Appeals, for the [fol. 112] Second Circuit, from the order, judgment or decree made herein on the 6th day of October, 1922, by Judge Learned Hand, wherein the said order denies the bankrupt herein his discharge, and fails to confirm the report of Special Commissioner Hon. Peter B. Olney, Jr., recommending the discharge of the Bankrupt herein, and said Bankrupt hereby appeals from each and every part of the said order.

Dated, New York, Oct. 13th, 1922.

Yours, etc., Laurence J. Bershad, Attorney for Bankrupt and
Petitioner, Office & P. O. Address, 291 Broadway, N. Y.
City, Manhattan Borough. No Herman Gerdes, Esq.,
Trustee for all Objecting Creditors, 225 Fourth Avenue,
New York City, Manhattan Borough; Zalkin & Cohen,
Esqs., Attorneys for Trustee and Objecting Creditors, 51
Chambers Street, New York City, Manhattan Borough.

Appeal allowed. — — —, U. S. D. J.

[fol. 113] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT
OF NEW YORK

[Title omitted]

ORDER DENYING APPLICATION FOR DISCHARGE

An application having been made by Abraham Lustgarten for a
discharge herein and appearances having been filed by the Corn Ex-

change Bank of New York City, Rusch & Co., Chatham & Phoenix National Bank, Warren Woolen Co., American Woolen Co. and S. B. Kafka in opposition to said discharge, and thereupon specifications of objections having been duly filed, and such specifications having been referred to Peter B. Olney as Special Master, to ascertain and report the facts with his opinion, and thereupon an order having been made directing Herman G. Gerdes, trustee in bankruptcy herein, to prosecute said specifications at the expense of the bankrupt estate, and he having thereupon appeared in support of said specifications, and such Special Master having filed his report dated July 31, 1922, recommending that the specifications of objections be overruled and the petition for discharge granted; and thereupon the bankrupt having come on to be heard,

Now, after hearing Laurence J. Bershad, Esq., attorney for the [fol. 114] bankrupt, in support of said motion to confirm, and Zalkin & Cohen, attorneys for the trustee, in opposition thereto, it is, on motion of Zalkin & Cohen, attorneys for the trustee in bankruptcy herein,

Ordered, that the said motion to confirm, be and the same is hereby denied; and it is further

Ordered, that the application for discharge of the said Abraham Lustgarten, bankrupt, be and the same is hereby denied; and it is further

Ordered that the fees of the special commissioner be and the same hereby are fixed in the amount of \$— and that the charges of the stenographer Herman Parkus, be and the same hereby are fixed in the amount of \$6.00; and the trustee of the estate of the above named bankrupt, is hereby directed to pay the same.

Dated, October 6, 1922.

L. H., U. S. D. J.

[fol. 115] UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT
OF NEW YORK

In Bankruptcy

No. 29252

In the Matter of ABRAHAM LUSTGARTEN, Bankrupt

STIPULATION AS TO TRANSCRIPT OF RECORD

It is hereby stipulated and agreed, that the foregoing is a true transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

Dated, October 20, 1922.

Zalkin & Cohen, Attorneys for Trustee. Laurence J. Bershad,
Attorney for Bankrupt.

[fol. 116] UNITED STATES OF AMERICA,
Southern District of New York:

[Title omitted]

CLERK'S CERTIFICATE

I, Alexander Gilchrist, Jr., Clerk of the District Court of the United States of America for the Southern District of New York, do hereby Certify that the foregoing is a correct transcript of the record of the said District Court in the above-entitled matter as agreed on by the parties.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, this 20th day of October, in the year of our Lord one thousand nine hundred and twenty-two, and of the Independence of the said United States the one hundred and forty—

Alexander Gilchrist, Jr., Clerk.

[fol. 117] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE
SECOND CIRCUIT

[Title omitted]

Before Rogers, Manton, & Mayer, Circuit Judges

OPINION, MAYER, J.

Appeal from an order of the District Court for the Southern District of New York denying the motion to confirm the report of a Special Master and denying the application for discharge of Lustgarten, the bankrupt.

The specifications of objection to bankrupt's petition for discharge were predicated upon four grounds, to wit: (1) a failure to keep proper books of account; (2) the giving of a false financial statement; (3) fraudulent concealment of \$2,000 from the trustee in bankruptcy; and (4) the making of false oath in the bankruptcy proceedings.

The Special Master in his report, however, stated that the only specifications on which testimony was introduced before him were those numbered (2) and (3) *supra*.

He reported that the specifications were not established and recommended discharge. The District Court apparently disregarded specification (3) but sustained specifications (1) and (2) *supra* and [fol. 118] denied discharge.

Laurence J. Bershad, for Appellant.

Zalkin & Cohen (Moses Cohen, of Counsel), for Trustee.

MAYER, Circuit Judge:

Specification 3 involved a question of fact, the details of which we need not discuss.

The Special Master held that specification 3 was not proved and that specification was properly disregarded by the District Court. The other two specifications rest on different facts and must be separately considered.

Specification 2. Under date of January 5, 1920, Lustgarten gave The Corn Exchange Bank a written statement of his financial condition, as of December 15, 1919, "for the purpose" as in the statement set forth "of obtaining loans" from the bank. The statement also provided:

"This statement is to be regarded by Abraham Lustgarten and by The Corn Exchange Bank as continuous and binding, and to form a true statement as to the assets and liabilities of the undersigned, and other matters, to be relied upon by The Corn Exchange Bank upon application by the undersigned, for all loans until another statement in writing shall be substituted for this, or this statement recalled. * * *

And further, whenever my financial condition is changed materially from the financial condition shown in the above statement, I agree to notify the said bank at once of such change, whether applications for further loans are made or not."

Under the headings of "Assets" and "Liabilities" the bankrupt [fol. 119] set forth various details. Only two of these are attached (the others being concededly correct), namely "Merchandise on hand (@ cost)—\$39,004.97" and "Accounts outstanding, due from customers, all good—\$30,642.50."

An expert accountant who examined the books testified that these items should have been \$24,721.17 and \$9,053.28 respectively.

The point of this testimony was that the accountant found that the figures from the books showed a net surplus of \$23,1258.43, whereas the statement of the bankrupt to the bank showed a net surplus of \$58,135.89.

The bankrupt insisted that he had the merchandise and accounts receivable in the amounts set forth, but that, owing to faulty book-keeping, these amounts did not appear in the books. This question of fact, however, was not passed upon by the Special Master because he relied upon *In re B. & R. Glove Corp.*, 279 F. R. 372.

We are unable to distinguish the facts in the case at bar from those in the case just cited. The nature of the statement is substantially the same. In the case at bar, the lapse of time between the date of the statement and the obtaining of the loan was nearly ten months, i. e., from January 4, 1920 to October 29, 1920, while in the *B. & R.* case, the time was about six months, i. e., from June 2,

1920 to December 10, 1920. Both periods were in the same year in respect of which general financial conditions are discussed in the B. & R. case.

In the case at bar, it is doubtful on the testimony whether it can be said that the bank relied on the bankrupt's statement; but, in any event, as pointed out by Judge Rogers in the B. & R. case, the bank was not justified in relying upon the statement.

[fol. 120] Specification 1. This specification seems not to have been relied upon before the Special Master, but apparently was urged before the District Court. The bankrupt testified that his nephew had been in his employ for about nine or ten years and that beginning in 1919, the nephew's salary was \$50.00 per week of which he drew \$30.00 and left with the bankrupt \$20.00 for savings purposes. In 1920, his compensation was increased to \$60.00, he drawing only \$40.00 and leaving the remaining \$20.00 with the bankrupt for the same purpose. In December 1920, the nephew became engaged to be married and requested his uncle to pay him the amount thus retained and this amount was paid. The accountant who was a witness on behalf of the trustee testified that in the bankrupt's general ledger under the heading "Commission on Sales," on December 8, 1922 there was an entry of \$1,000.00 as having been paid to the nephew, Louis Lustgarten and on December 22, 1922, \$1,000.00, which was posted from the cash book. Thus there was no concealment whatever of the payment of these amounts to the nephew. There is no proof that the bankrupt was insolvent in December 1920 and, as pointed out by the Special Master, the trustee did not call the nephew or any other person to show that, in any manner, the transaction was not genuine. The most that is argued is that the books did not contain credit entries to offset these debits. Accurate bookkeeping would have required a proper credit entry of \$20.00 weekly,—a small amount as compared with the volume of business of the bankrupt. In the statement to the bank, the liabilities for merchandise and bank accommodations are carefully and accurately set forth; and the failure to note these small credit entries we think was due to inadvertent faulty bookkeeping and not to any [fol. 121] intent to conceal financial conditions.

We are satisfied from the record that the trustee failed to adduce proof to show that the bankrupt intended to conceal his financial condition by failing to make these credit entries of \$20.00 weekly and such intent must be proved to bar a discharge under Section 14 (b) (2) of the Bankruptcy Law.

The order is reversed with costs and the District Court is instructed to grant a discharge to the bankrupt.

[File endorsement omitted.]

[fol. 122] At a Stated Term of the United States Circuit Court of Appeals in and for the Second Circuit, Held at the Court Rooms, in the Post Office Building, in the City of New York, on the 2nd Day of April, One Thousand Nine Hundred And Twenty-three

Present: Hon. Henry Wade Rogers; Hon. Martin T. Manton;
Hon. Julius M. Mayer, Circuit Judges.

[Title omitted]

JUDGMENT

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States, for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged and decreed that the order of said District Court be and it hereby is reversed with costs and the District Court is instructed to grant a discharge to the bankrupt.

H. W. R.

M. T. M.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

[fol. 123] [File endorsement omitted.]

[fol. 124] CLERK'S CERTIFICATE

UNITED STATES OF AMERICA,
Southern District of New York, ss:

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby Certify that the foregoing pages, numbered from 1 to 124 inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of In the Matter of Abraham Lustgarten, Bankrupt-Appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 7th day of May, in the year of our Lord One Thousand Nine Hundred and twenty three and of the Independence of the said United States the One Hundred and forty seventh.

Wm. Parkin, Clerk. [Seal of the United States Circuit Court of Appeals, Second Circuit.]

[fol. 125] WRIT OF CERTIORARI AND RETURN—Filed July 9, 1923

UNITED STATES OF AMERICA, ss:

[Seal of the Supreme Court of the United States.]

The President of the United States of America to the Honorable the Judges of the United States Circuit Court of Appeals for the Second Circuit, Greeting:

Being informed that there is now pending before you a suit entitled In the matter of Abraham Lustgarten, Bankrupt, which suit was removed into the said Circuit Court of Appeals by virtue of an appeal from the District Court of the United States for the Southern District of New York, and we, being willing for certain reasons that the said cause and the record and proceedings therein should be certified by the said Circuit Court of Appeals and removed into the Supreme Court of the United States, Do hereby command you that [fol. 126] you send without delay to the said Supreme Court, as aforesaid, the record and proceedings in said cause, so that the said Supreme Court may act thereon as of right and according to law ought to be done.

Witness the Honorable William H. Taft, Chief Justice of the United States, the twenty-third day of June, in the year of our Lord one thousand nine hundred and twenty-three.

Wm. R. Stansbury, Clerk of the Supreme Court of the United States.

[fol. 127] [Endorsed:] File No. 29,632. Supreme Court of the United States, October Term, 1922. No. 1082. Herman G. Gerdes, as Trustee in Bankruptcy, etc., vs. Abraham Lustgarten. Writ of Certiorari.

[fol. 128] Copy

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

In the Matter of ABRAHAM LUSTGARTEN, Bankrupt

It is hereby stipulated, that the transcript already filed in the Clerk's Office of the Supreme Court of the United States, with the petition for the writ of certiorari, be taken as the return to said writ dated June 23, 1923.

Dated, N. Y. July 5th, 1923.

Zalkin & Cohen, Counsel for Herman G. Gerdes, Trustee.
L. J. Bershad, Counsel for Abraham Lustgarten, Bankrupt.

[fol. 129] To the Honorable the Supreme Court of the United States,
Greeting:

The record and all proceedings whereof mention is within made, having lately been certified and filed in the office of the clerk of the Supreme Court of the United States, a copy of the stipulation of counsel is hereto annexed, and certified as the return to the writ of certiorari issued herein.

Dated, New York July 6, 1923.

Wm. Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit. [Seal of the United States Circuit Court of Appeals, Second Circuit.]

[fol. 130] [File endorsement omitted.]

[fol. 131] [File endorsement omitted.]

No. 1 1922 70

MAY 21 1923

WM. R. STANSBURY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1922.

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13

HERMAN G. GERDES, as trustee in bankruptcy
of ABRAHAM LUSTGARTEN, Bankrupt,
Petitioner,

—VS.—

ABRAHAM LUSTGARTEN,
Respondent.

**PETITION FOR WRIT OF CERTIORARI, BRIEF
AND NOTICE OF APPLICATION.**

ZALKIN & COHEN,
Attorneys for Petitioner,
No. 49 Chambers Street,
New York City.



SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1922.

HERMAN G. GERDES, as trustee
in bankruptcy of ABRAHAM
LUSTGARTEN, Bankrupt,
Petitioner,

—VS.—

ABRAHAM LUSTGARTEN,
Respondent.

TO THE HONORABLE, THE CHIEF JUSTICES AND ASSO-
CIATED JUSTICES OF THE SUPREME COURT OF THE
UNITED STATES:

The petition of HERMAN G. GERDES, trustee in
bankruptcy of Abraham Lustgarten, bankrupt,
filed pursuant to provision 25-D of the Bankruptcy
Act of 1898, respectfully represents:

FIRST. An involuntary petition in bankruptcy
was filed against Abraham Lustgarten, the bank-
rupt herein, on the 1st day of March, 1921, and
an adjudication followed on the 4th day of April,
1921. The bankrupt applied for a discharge and
certain creditors entered appearances and duly
filed specifications of grounds of their opposition
to the bankrupt's petition for discharge. Pur-
suant to an order made by the referee in bank-
ruptcy, petitioner was duly authorized to prosecute

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the objections to bankrupt's petition for discharge upon the specifications filed by creditors.

SECOND. Four grounds of opposition were specified, to-wit: (1) that with intent to conceal his financial condition, the bankrupt had destroyed, concealed or failed to keep books of account or records, from which such condition might be ascertained; (2) that he had obtained money or property on credit upon material false statement in writing made by him to a person or his representative for the purpose of obtaining credit from such person; (3) that he had subsequent to the first day of the four months immediately preceding the filing of the petition transferred, removed or sold, or permitted to be transferred, removed or sold, \$2,000 of his property, with intent to hinder, delay or defraud his creditors; (4) that he had committed offenses punishable by imprisonment as provided in the Acts of Congress relating to Bankruptcy, and that he knowingly made a false oath in the bankruptcy proceedings (Rec. pp. 6 to 11).

THIRD. On January 5, 1920, the bankrupt delivered to the Corn Exchange Bank a financial statement reflecting his condition as of December 15, 1919, which financial statement showed the bankrupt to have a net worth on December 15, 1919 of \$58,135.89. It was proven by the bankrupt's books of account that on December 15, 1919 his net worth was \$23,158.43 indicating that the financial statement was inflated to the extent of \$32,388.46 (Rec. fols. 116, 117).

This financial statement contained the following:

"This statement is to be regarded by Abraham Lustgarten and by the Corn Exchange

Bank as continuous and binding, and to form a true statement of the assets and liabilities of the undersigned, and other matters to be relied upon by the Corn Exchange Bank upon application by the undersigned for all loans until another statement shall be substituted for this or this statement recalled * * * and further whenever my financial condition is changed materially from the financial condition shown in the above statement, I agree to notify the said bank at once of such change whether applications for further loans are made or not" (Rec. pp. 104, 106).

The Corn Exchange Bank extended credit to the bankrupt upon the filing of this statement on October 29, 1920, November 4, 1920 and February 11, 1921, no notice having been received by the Bank of any change in the financial condition of the bankrupt and the statement not having been recalled.

FOURTH. The bankrupt paid to one Louis Lustgarten, a nephew, the sum of \$2,000 within three months prior to the bankruptcy (Rec. fols. 306, 308). No entries appear in the bankrupt's books showing any indebtedness to Louis Lustgarten (Rec. fols. 111, 113). The bankrupt testified that said nephew was employed in the bankrupt's business during the year 1919 at a salary of \$50 and in 1920, at a salary of \$60, and that the bankrupt deducted \$20 each week from said nephew's salary and held same as savings for him. In December, 1920, the nephew requested payment of his savings and \$2,000 was paid to him (Rec. fols. 306, 308). The only entry in the books of the bankrupt is an entry of payment as follows: December 8th,

\$1,000; December 22nd, \$1,000, which entries appear in the cash book and also appear to be posted to a book of accounts with salesmen (fols. 111, 113). Nothing appears in the books as credit to offset these debits (fol. 113). The Special Master held that the Corn Exchange Bank had no right to rely upon the statement in extending credit after a period of ten months had elapsed from the date of the statement (Rec. fol. 6); and the Special Master also found in favor of the bankrupt upon the facts with respect to the specifications of fraudulent concealment of \$2,000 from the trustee in bankruptcy and failure to keep proper books of account. The District Court reversed the Special Master and sustained the specifications as to the false financial statement and as to the failure to keep proper books of account (Rec. fols. 321, 323). The Circuit Court of Appeals reversed the District Court and sustained the Special Master.

FIFTH. The Circuit Court of Appeals held, following its earlier decision, in *re B. & R. Glove Co.*, 279 Fed. Rep. 372, that the bank had no right to rely upon the financial statement because of the lapse of nearly ten months between the date of the statement and the extension of credit. The Circuit Court of Appeals also held that the failure to note the obligation of the bankrupt to his nephew was due to inadvertent, faulty bookkeeping, and not to any intent to conceal his financial condition, and that the trustee failed to adduce proof that the bankrupt's failure to enter the credits due his nephew was with intent to conceal his financial condition.

SIXTH. Your petitioner seeks to have this Court determine the following questions:

(1) Whether a bankrupt who issues a financial statement containing a provision that the same may be relied upon by the creditor until another statement shall be substituted, and a further provision to the effect that he will advise of any change in his financial condition, may obtain his discharge if he gave no notice of a change of his condition and gave no other statement, if the creditor relied upon the statement, and if such financial statement proves to be false not only at the time when the statement was acted upon but that it was originally false when made;

(2) Whether the omission by a bankrupt to enter in his books a debt due a relative, which debt was paid within three months prior to the bankruptcy, is a failure to keep proper books of account within the meaning of Section 14-B, Subd. 2 of the Bankruptcy Act.

SEVENTH. Your petitioner assigns the following reasons for the allowance of the writ:

(a) The questions presented are of general importance to the commercial world because one question involves the measure of reliance which banks and merchants may place upon a financial statement issued for the purpose of obtaining credit; and the other, whether a bankrupt may with impunity fail to enter in his books of account debts due to relatives.

(b) It is important that this Court pass upon both questions because the holding of the Circuit Court of Appeals renders a bankrupt immune to the penalty prescribed by the Bankruptcy Act for the giving of a false finan-

cial statement, unless a merchant before extending credit obtains a new statement every few months, notwithstanding the express agreement of the bankrupt that the creditor may rely upon the statement until notified of a change; and because the ruling of the Circuit Court of Appeals may encourage the fraudulent practice on the part of some bankrupts to pay moneys to relatives and friends upon fictitious debts, unless such bankrupts are held to strict accountability for failure to enter such obligations in books of account.

(c) The decision in this case with respect to the false financial statement is contrary to the decision of the Circuit Court of Appeals in the Fifth Circuit, *In re Regan vs. Cotton*, 200 Fed. Rep. 546, and the decision of the Circuit Court of Appeals in the Third Circuit, *Haimowich vs. Mandel*, 243 Fed. Rep. 338.

WHEREFORE, your petitioner prays that this Honorable Court will grant a writ of certiorari to the Circuit Court of Appeals for the Second Circuit, commanding the said Court to certify and send to this Court a transcript of the record and all proceedings of said Circuit Court of Appeals in this case, therein entitled "In the Matter of *Abraham Lustgarten*, bankrupt-appellant," to the end that this case may be reviewed and determined by this Court, as provided by law, and the judgment and order of said Circuit Court of Appeals may be reversed by this Honorable Court.

HERMAN G. GERDES,
as Trustee in Bankruptcy,
Petitioner.

CITY, COUNTY AND STATE OF NEW YORK, ss.:

HERMAN G. GERDES, being duly sworn, deposes and says that he is the petitioner herein; that he has read the foregoing petition and that the allegations thereof are true as he verily believes.

HERMAN G. GERDES.

Subscribed and sworn to before me, this
19th day of May, 1923.

LEWIS H. SAPER,

Notary Public, Kings County,

Kings County Clerk's No. 164,

Kings County Register's No. 4187,

N. Y. County Clerk's No. 482,

N. Y. County Register's No. 4487.

Commission expires March 30, 1924.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

STATEMENT OF FACTS.

The facts are set forth in the petition annexed but it is desired to supplement the same by the following:

The financial statement referred to contained the following figures:

ASSETS.

Merchandise	\$39,004.97
Accounts Receivable	30,642.50
Cash in Bank	9,042.79
Cash on hand	945.63
Fixtures & Machinery	1,500.00
<hr/>	
Total	\$81,135.89

LIABILITIES.

For Merchandise	\$3,000.00
For Bank Accommodation	20,000.00
Total	\$23,000.00
<hr/>	
Net Surplus	\$58,135.89

(Exhibit 1 of March 17, 1922, Rec. pp. 104-105.)

The items claimed to be falsified were "Merchandise \$39,004.97" and "Accounts Receivable \$30,642.50." The falsity of these items were proved by comparison with the bankrupt's books of account (Rec. fols. 116-117). The books showed the bankrupt's merchandise to be \$24,721.17 (fol. 116) and

accounts receivable to be \$9,053.25 (fol. 117). The bankrupt attempted to explain this discrepancy as follows:

The inventory of \$24,721.17, shown on the bankrupt's books, consisted of woolen piece goods; that due to the faulty method of bookkeeping, this inventory failed to include linings, silks, satins, velvets and manufactured goods, coats, suits, dresses and capes, and also failed to include paper-boxes, wrapping paper, twines, trimmings, stationery and printing, and that although the books showed an inventory of only \$24,721.17, as a matter of fact the bankrupt did have merchandise which inventoried at \$39,004.97 the amount shown in the financial statement.

Likewise the discrepancy in the outstanding accounts is explained by faulty bookkeeping due to the failure of the bookkeeper to enter upon the books upon closing, items of merchandise outstanding with salesmen, merchandise outstanding with customers shipped on approval and merchandise shipped customers and not entered in the books, the sales having been made a day or two before the closing of the books and of which sales memoranda were entered upon slips of paper on the bookkeeper's desk and not carried into the books (fols. 171-178).

The Special Master not having passed upon the questions of fact with respect to the falsity of the financial statement, the only purpose in directing attention to the bankrupts is in connection with the specification of the failure to keep proper books of account.

POINT I.

THE DECISION OF THE LEARNED CIRCUIT COURT OF APPEALS IS IN CONFLICT WITH THE DECISION IN RE RAGAN, MALONE & CO. vs. COTTON & PRESTON et al., CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT, 200 Fed. Rep. 546; AND HAIMOWICH vs. MANDEL, CIRCUIT COURT OF APPEALS, THIRD CIRCUIT, 243 Fed. Rep. 338.

In re Ragan, Malone & Co. vs. Cotton & Preston, et al. (supra), the financial statement contained the following clause:

“This statement shall be binding for each purchase now or hereafter made unless changed by written authority from the undersigned.”

The statement is dated August 5, 1907. Credit was obtained from time to time up to March 6, 1908.

We quote from the opinion of Pardee, C.J., at page 550:

“There is considerable discussion in the briefs as to the effect, legal and moral, of the declaration in the first paragraph of the statement made by Preston, to wit:

“This statement shall be binding for each purchase now or hereafter made, unless changed by written authority from the undersigned.”

And it is argued that, as the bankrupts before adjudication had paid for the first purchase of goods obtained under the statement, Ragan, Malone & Co. had no right to rely upon it as a basis of credit for any subsequent pur-

chase. The account of Ragan, Malone & Co. with the bankrupts appears to be a running account, covering purchases from time to time for a little over one year, on which the credits made at no time left the account fully paid up, so that it is only an assumption, depending upon the correct imputation of payments, to say that the first purchase was ever fully paid for. But, be that as it may, *the parties agreed that the statement should be binding for continuous credit. The evidence is that it was relied upon by the creditors in the subsequent credits, as well as in the first, and we know of no reason to go behind the agreement.*" (Italics are ours.)

In re Haimowich vs. Mandel (supra), the financial statement was issued in March, 1912, to the Mercantile Agency of R. G. Dun & Co. In September, 1912, the creditor received from Dun & Co. the bankrupt's statement and sold merchandise relying upon it.

We quote from the opinion of Wooley, C.J., at 342:

"the test of whether a false statement given upon one date and communicated and acted upon on a later date operates as a bar to a discharge, is two-fold: (1) Whether the agency was the representative of the prospective creditor at the time the statement was communicated to and acted upon by him; and (2) whether at that time the false statement was still in force and binding upon the bankrupt, to be determined according as it is found that the sale on credit was or was not the proximate result of the statement (*In re Braverman* (D.

C.) 199 Fed. 863, 28 Am. Bankr. Rep. 513), and that its original falsity was or was not the thing that worked the mischief."

In re Levenson, 223 Fed. Rep. 874 (District Court of Massachusetts), a false financial statement was given containing a provision that it should be considered continuing in force until the creditor was notified to the contrary. The financial statement was dated December 12, 1911, as of December 4, 1911, various credits were extended, the last being on July 12, 1912. The Court sustained the objections to confirmation of composition.

POINT II.

THE FACTS IN THE CASE OF B. & R. GLOVE CORPORATION, 279 Fed. Rep. 372, WHICH THE CIRCUIT COURT OF APPEALS FOLLOWED IN THIS CASE ARE DIFFERENT THAN THE FACTS IN THIS CASE.

In B. & R. Glove Corporation (supra), the financial statement contained the following provision:

"The undersigned also expressly agrees to notify the Irving National Bank of any material reduction of financial responsibility of the undersigned."

The provision in the financial statement in the instant case is as follows:

"This statement is to be regarded by Abraham Lustgarten and by the Corn Exchange Bank as continuous and binding, and to form a true statement of the assets and liabilities of the undersigned, and other matters to be

relied upon by the Corn Exchange Bank upon application by the undersigned for all loans until another statement shall be substituted for this or this statement recalled * * * and further whenever my financial condition is changed materially from the financial condition shown in the above statement, I agree to notify the said bank at once of such change whether applications for further loans are made or not" (Rec. pp. 104, 106).

The test applied by the Court *In re Haimowich vs. Mandel* is the test which should have been applied in this case, namely, whether "the original falsity was or was not the thing that worked the mischief."

From the record folios 128-129, it appears that upon giving the statement in question, the bankrupt established a line of credit to the extent of \$15,000, which was fixed by the Board of Directors of the creditor bank. It was the original statement which gave the bankrupt his credit standing with the bank to the extent of \$15,000.

The District Court properly applied this test:

"Thus, the questions are of fact, and are, did the creditor actually rely on the financial statement, and, under the circumstances shown, did he have a right so to rely.

In my judgment, if a man gives to a Bank from whom he regularly borrows, a statement which contains (as the commissioner finds this one did) that it was a continuing statement and that the borrowee would notify the Bank at once of any material changes in his exhibited financial condition,—upon such a statement, the Bank has a right to rely until such

notice is given. That is the very bargain between the borrower and lender" (Rec. fols. 320-321).

POINT III.

THE LEARNED CIRCUIT COURT OF APPEALS ERRED IN REVERSING THE FINDING OF THE DISTRICT COURT THAT THERE WAS A FAIL- URE TO KEEP PROPER BOOKS.

In re Hanna, 168 Fed. Rep. 238, the Circuit Court of Appeals, Second Circuit, it was said:

"A provision intended to insure the keeping of correct and complete accounts should be rigidly enforced, especially one whose operation is made to depend upon intention, excluding mistake or neglect."

In re Koelle, 22 A. B. R. 515, the District Court, Eastern District of Pennsylvania, held:

"Where a bankrupt's indebtedness amounted to \$21,000, of which \$8,000 was due to merchandise creditors whose names appeared upon his books, and the balance was due to his wife, relatives and various friends for loans, and the only explanation he gave why none of their names appeared on his books was that he knew the lenders would not push him and that he thought it was not necessary for his creditors to know that he had money from his wife, he will be denied his discharge on the ground that, with intent to conceal his financial condition, he failed to keep books of account or records from which such condition might be ascertained."

The District Court held:

"The bankrupt maintains that he really owed shortly before his failure \$2,000 to his nephew, who had been in his employment.

Such a debt was by no means trifling considering the extent of this bankrupt's business and his available assets. The existence of the debt made a material difference in his net assets.

No trace of the debt is found in his books and the intent necessary by the statute is one of reasonable inferences" (fols. 321, 322).

We advert to the fact that the bankrupt issued a false statement which he attempted to explain by failure to make proper entries in his books of account. It is inconceivable that the books should have erred to the extent of \$32,388.46. From the entire record in this case, the District Court was justified in drawing the inference of intent, for no other inference could be drawn from a failure to enter a debt which was accruing through a period of two years prior to bankruptcy.

Respectfully submitted,

MOSES COHEN,
Attorney for Petitioner.

NOTICE.

SIR:

PLEASE TAKE NOTICE, that the annexed petition and brief, and a copy of the record in this cause, will be submitted to the Supreme Court of the United States, in its Court Room, at the Capitol in the City of Washington, D. C., on the 4th day of June, 1923, at the opening of Court on that day.

Dated, N. Y., May 19, 1923.

Yours, &c.,

MOSES COHEN,
Attorney for Petitioner,
No. 49 Chambers Street,
New York City.

To:

LAURENCE J. BERSHAD, ESQ.,
Attorney for Respondent,
No. 291 Broadway,
N. Y. City.

The foregoing notice is hereby accepted, and delivery of a copy thereof and of the foregoing petition and brief is hereby acknowledged.

LAURENCE J. BERSHAD,
Attorney for Abraham Lustgarten,
Respondent.

FEB 4 1924

WM. R. STANSBURY
CLERK

IN THE
Supreme Court of the United States

OCTOBER TERM, 1923.

No.

70

HERMAN G. GERDES, as trustee in bankruptcy
of ABRAHAM LUSTGARTEN, Bankrupt,
Petitioner,
—against—
ABRAHAM LUSTGARTEN,
Respondent.

BRIEF AND ARGUMENT FOR PETITIONER.

ZALKIN & COHEN,
Attorneys for Petitioner,
49 Chambers Street,
New York City.

MOSES COHEN,
Counsel.



STATEMENT OF CASE.

This case comes before this Court upon a writ of certiorari to review an order of the Circuit Court of Appeals, Second Circuit, which reversed a decree of the District Court and instructed the District Court to grant a discharge in bankruptcy to Abraham Lustgarten.

An involuntary petition in bankruptcy was filed against Abraham Lustgarten, on the 1st day of March, 1921, and an adjudication followed on the 4th day of April, 1921. The bankrupt applied for a discharge and certain creditors entered appearances and filed specifications of grounds of their opposition to the bankrupt's application. Pursuant to order duly made, petitioner was authorized to prosecute the objections to bankrupt's application upon the specifications filed by creditors.

Four grounds of opposition were specified, to-wit: (1) that with intent to conceal his financial condition, the bankrupt had destroyed, concealed or failed to keep books of account or records, from which such condition might be ascertained; (2) that he had obtained money or property on credit upon a materially false statement in writing made by him; (3) that he had, subsequent to the first day of the four months immediately preceding the filing of the petition, transferred, removed or sold, or permitted to be transferred, removed or sold \$2,000 in value of his property, with intent to hinder, delay or defraud his creditors; (4) that he had committed offenses punishable by imprisonment as provided in the Acts of Congress relating to Bankruptcy, in that he knowingly made a false oath in the bankruptcy proceedings (Rec., pp. 3-6).

The following facts appear from the evidence adduced to support the specifications: On January 5, 1920, the bankrupt delivered to the Corn Exchange Bank a financial statement (Trustee's Ex. 1, p. 66) reflecting his condition as of December 15, 1919, which financial statement showed the bankrupt to have a net worth on December 15, 1919, of \$58,135.89. It was proven by the bankrupt's books of account that on December 15, 1919, his net worth was \$23,158.43 indicating that the financial statement was inflated to the extent of \$32,388.46 (pp. 24-25).

This financial statement contained the following:

*"This statement is to be regarded by Abraham Lustgarten and by the Corn Exchange Bank as continuous and binding, and to form a true statement of the assets and liabilities of the undersigned, and other matters to be relied upon by the Corn Exchange Bank upon application by the undersigned for all loans until another statement shall be substituted for this or this statement recalled * * * and further whenever my financial condition is changed materially from the financial condition shown in the above statement, I agree to notify the said bank at once of such change whether applications for further loans are made or not" (p. 67).*

The financial statement contained the following figures:

ASSETS.

Merchandise	\$39,004.97
Accounts Receivable	30,642.50
Cash in Bank	9,042.79
Cash on hand	945.63
Fixtures & Machinery	1,500.00

Total\$81,135.89

LIABILITIES

For Merchandise	\$ 3,000.00
For Bank Accommodation.....	20,000.00
Total	23,000.00

Net Surplus\$58,135.89

The items claimed to be falsified were "Merchandise \$39,004.97" and "Accounts Receivable \$30,642.50," and were proved false by comparison with the bankrupt's books of account which showed the bankrupt's merchandise to be \$24,721.17 (p. 24) and accounts receivable to be \$9,053.25 (p. 24).

The bankrupt attempted to explain this discrepancy by testifying without referring to or supporting his statements by any records that the inventory of \$24,721.17 shown on his books, consisted of piece goods, and because of the faulty method of book-keeping, this inventory failed to include linings, silks, satins, velvets and manufactured goods, coats, suits, dresses and capes, and also failed to include paper-boxes, wrapping paper, twines, trimmings, stationery and printing, and that although the books showed an inventory of only \$24,721.17 he did have merchandise inventoried at \$39,004.97, the amount shown in the financial statement.

Likewise the discrepancy in the outstanding accounts is explained by faulty bookkeeping claimed to be due to the failure of the bookkeeper to enter upon the books items of merchandise outstanding with salesmen, merchandise outstanding with customers shipped on approval, and merchandise shipped to customers and not entered in the books, the sales having been made a day or two before the closing of the books and of which sales memoranda were entered upon slips of paper on the bookkeeper's desk and not carried into the books (pp. 37-38).

The Corn Exchange Bank extended credit to the bankrupt on October 29, 1920, November 4, 1920, and February 11, 1921, no notice having been received by the Bank of any change in the financial condition of the bankrupt and the statement not having been recalled (pp. 14-26).

The bankrupt paid to one Louis Lustgarten, a nephew, the sum of \$2,000 within three months prior to the bankruptcy (Rec. 23, fol. 38). The record of this payment appears in the general ledger, page 45, under the heading of "Commissions on Sales." No entries appear in the bankrupt's books showing any indebtedness to Louis Lustgarten and no entry appears in the salesmen's commission book indicating that Louis Lustgarten was entitled to receive any commissions (Rec. p. 24, fol. 38). The bankrupt testified that said nephew was employed in the bankrupt's business during the year 1919 at a salary of \$50 and in 1920 at a salary of \$60, and that the bankrupt deducted \$20 each week from said nephew's salary and held same as savings for him. In December, 1920, the nephew requested payment of his savings and \$2,000 was paid to him (Rec. p. 65, fol. 103). The only entry in the books of the bankrupt is an entry of

payment as follows: December 8th, \$1,000; December 22nd, \$1,000, which entries appear in the cash book and also appear to be posted in the general ledger under the heading "Commissions on Sales" (pp. 23-24, fol. 38). Nothing appears in the books as a credit to offset these debits (fol. 113).

The Special Master did not pass upon the question of fact involved in the determination of whether the financial statement was in fact false, holding that it was unnecessary for him to do so under the decision of the Circuit Court of Appeals, Second Circuit (*B. & R. Glove Corporation*, 279 Fed. 372); and that under the decision of the Circuit Court of Appeals, the Corn Exchange Bank had no right to rely upon this statement in extending credit after a period of ten months elapsed from the date of the statement (Rec. p. 2); and the Special Master found in favor of the bankrupt upon the facts with respect to the specifications of fraudulent concealment of \$2,000 from the trustee in bankruptcy and failure to keep proper books of account. The District Court reversed the Special Master and sustained the specifications as to the false financial statement and as to the failure to keep proper books of account (Rec. 68). The Circuit Court of Appeals reversed the District Court and sustained the Special Master (p. 72).

Petitioner respectfully submits that the Circuit Court of Appeals erred in respect to the matters set forth in the following specifications of error.

SPECIFICATIONS OF ERROR.

1. The Circuit Court of Appeals erred in reversing the order of the District Court which denied the bankrupt a discharge.

2. The Circuit Court of Appeals erred in holding that the Corn Exchange Bank was not justified in relying upon the bankrupt's financial statement when it extended credit thereon.

3. The Circuit Court of Appeals erred in holding that its decision in *B. & R. Glove Corporation*, 279 Fed. 372 was decisive of this case.

4. The Circuit Court of Appeals erred in holding that the bankrupt's failure to enter in his books the alleged indebtedness to his nephew, Louis Lustgarten, and the entry of the payments to Louis Lustgarten did not constitute a failure to keep books of account or records within the requirements of the Bankruptcy Act.

POINT I.

THE PROOF ADDUCED BY THE PETITIONER ESTABLISHED THAT THE BANKRUPT, WITH INTENT TO CONCEAL HIS FINANCIAL CONDITION, OBTAINED MONEY OR PROPERTY ON CREDIT, UPON A MATERIALLY FALSE STATEMENT IN WRITING MADE BY HIM FOR THE PURPOSE OF OBTAINING CREDIT. THE CORN EXCHANGE BANK WAS JUSTIFIED IN RELYING UPON THE FINANCIAL STATEMENT ISSUED BY THE BANKRUPT, NOTWITHSTANDING THE LAPSE OF TEN MONTHS BETWEEN THE DELIVERY OF THE STATEMENT AND THE EXTENSION OF CREDIT THEREON.

Bankruptcy Act, Section 14, Subdivision B-3;

Ragan, Malone & Co., vs. Cotton & Preston,
200 Fed. Rep. 546;

In re Levinsohn, 223 Fed. Rep. 874;
Haimowich vs. Mandel, 243 Fed. Rep. 338.

POINT II.

THE PROOF ADDUCED BY THE PETITIONER ESTABLISHED THAT THE BANKRUPT, WITH INTENT TO CONCEAL HIS FINANCIAL CONDITION, DESTROYED, CONCEALED OR FAILED TO KEEP BOOKS OF ACCOUNT OF RECORDS FROM WHICH SUCH CONDITION MIGHT BE ASCERTAINED.

Bankruptcy Act, Section 14, Subdivision B-2;

In re: Janowitz, 219 Fed. Rep. 876;

In re: Newburg & Dunham, 209 Fed. Rep. 198;

In res Hanna, 168 Fed. Rep. 238;

In re: Koelle, 171 Fed. Rep. 257.

ARGUMENT ON POINT I.

Sec. 14, sub. B(3) of the Bankruptcy Act provides that a bankrupt may receive his discharge "unless he has * * * obtained money or property on credit upon a materially false statement in writing made by him to any person or his representative for the purpose of obtaining credit from such person."

In *re B. & R. Glove Corporation*, 279 Fed. 372, the precedent relied upon by the Circuit Court of Appeals in deciding the present case, the Court says at page 380:

"As respects that part of the financial statement in which it was agreed that the debtor would notify the creditor of any material re-

duction of the latter's financial responsibility, it is not to be understood as imposing an obligation unlimited in time, but only during such a reasonable time as the financial statement itself could be relied upon. This case differs materially from that of the *Atlas Shoe Co. vs. Bechard*, *supra*, upon which the claimant strongly relies. In that case the agreement expressly provided that it might be considered as a continuing statement, 'and a new and original statement of our assets and liabilities upon each and every purchase of goods from them (it) hereafter until we advise them in writing to the contrary'. The Court said:

"This is something more than a representation true at the time and a mere failure to notify of a change of conditions. Such a representation may be relied upon only for a reasonable time. It is here expressly agreed that it may be considered a continuing statement, and a new and original statement upon each and every purchase of goods. That can mean nothing less than that it is to have the same force and effect "as a basis for credit" that it would have if it accompanied each order of goods and was made as of the date of said order. The intention of the parties is apparent and unmistakable that the plaintiff might rely upon it the same when the last as when the first goods were sold.'

"In the instant case the agreement was simply to notify of any material reduction of financial responsibility, which we construe to refer to the period of 'reasonable time' within which the statement itself continued in force."

In the present case, the language of the financial statement is:

"This statement is to be regarded by Abraham Lustgarten and by the Corn Exchange Bank as continuous and binding and to form a true statement as to the assets and liabilities of the undersigned and other matters to be relied upon by the Corn Exchange Bank upon application by the undersigned for all loans until another statement in writing shall be substituted for this or this statement recalled."

The language of the financial statement of *Atlas Shoe Co. vs. Bechard* is as follows:

"The above is a true and accurate statement of all our assets and liabilities and is presented to the Atlas Shoe Co. as a basis for credit. This statement may be considered by the Atlas Shoe Co. a continuing statement of our affairs, and a new and original statement of our assets and liabilities upon each and every purchase of goods from them hereafter until we advise them in writing to the contrary."

The Circuit Court of Appeals indicates the distinction between B. & R. Glove Corporation and *Atlas Shoe Co. vs. Bechard* due to the difference in the language of the financial statements but overlooks the fact that the language of the financial statement in the present case is the equivalent of the language of the financial statement in *Atlas Shoe Co. vs. Bechard*. *Atlas Shoe Co. vs. Bechard* and not B. & R. Glove Corporation should be *stare decisis* of this case.

In *Ragan, Malone & Co. vs. Cotton & Preston*, 200 Fed. 546 (Circuit Court of Appeals, Fifth Cir-

cuit), a financial statement was issued which contained the following provision:

"This statement shall be binding for each purchase now or hereafter made unless changed by written authority from the undersigned."

The Court there says:

"(1) There is considerable discussion in the briefs as to the effect, legal and moral, of the declaration in the first paragraph of the statement made by Preston, to wit:

'This statement shall be binding for each purchase now or hereafter made, unless changed by written authority from the undersigned.'

"And it is argued that, as the bankrupts before adjudication had paid for the first purchase of goods obtained under the statement, Ragan, Malone & Co. had no right to rely upon it as a basis of credit for any subsequent purchase. The account of Ragan, Malone & Co. with the bankrupts appears to be a running account, covering purchases from time to time for a little over one year, on which the credits made at no time left the account fully paid up, so that it is only an assumption, depending upon the correct imputation of payments, to say that the first purchase was ever fully paid for. But, be that as it may, the parties agreed that the statements should be binding for continuous credit. The evidence is that it was relied upon by the creditors in the subsequent credits, as well as in the first, and we know of no reason to go behind the agreement."

In *Haimowich vs. Mandel* (Circuit Court of Appeals, Third Circuit), the Court says:

"the test of whether a false statement given upon one date and communicated and acted upon on a later date operates as a bar to a discharge, is twofold: (1) Whether the agency was the representative of the prospective creditor at the time the statement was communicated to and acted upon by him; and (2) whether at that time the false statement was still in force and binding upon the bankrupt, to be determined according as it is found that the sale on credit was or was not the proximate result of the statement (In re *Braverman* (D. C.) 199 Fed. 863, 28 Am. Bankr. Rep. 513), and that its original falsity was or was not the thing that worked the mischief."

In re *Levenson*, 223 Fed. Rep. 874, (District Court, Massachusetts) the statement contained a provision that it should be considered as continuing in force and as being a true statement of the bankrupt's financial condition until the trust company was notified to the contrary. The statement was made about December 12, 1911. The next extension of credit thereunder was July 12, 1912. There was no evidence that the bankrupt made any disclosure to the trust company of any change in his financial condition. The Court therefore sustained the objection to the confirmation of the bankrupt's proposed composition upon the ground that he had made a false financial statement.

If we apply the test adopted by the Court in *Haimowich vs. Mandel*, whether the statement's "original falsity was or was not the thing that worked the mischief," there is but one possible con-

clusion from the facts adduced in this case, and that is that the falsity did work the mischief.

Both William C. Horton, the manager of the Corn Exchange Bank, and Charles A. Ingalls, assistant credit manager, testified that they relied upon the financial statement and that the bankrupt had been given a standing line of credit of \$15,000 which was originally fixed by the Board of Directors (Rec. pp. 15-22 and 25-30). It thus appears that upon consideration of the statement the Board of Directors of the Corn Exchange Bank originally fixed the bankrupt's credit at \$15,000 and on the occasion of the extension of credits, testified to by Mr. Horton and Mr. Ingalls, they referred to the credit file, and, not having received any notice from the bankrupt or from any other source of a change in his financial condition (and the bankrupt being within the credit limits of \$15,000), they extended the desired credit.

The practical effect of the decision in *B. & R. Glove Corporation* is that there is no legal distinction between the ordinary financial statement and what is commonly designated a continuing financial statement; that the attempt of the parties to make a continuing financial statement is ineffectual; and that the language used by the parties in attempting to draft a continuing statement is a nullity.

The Courts must give effect to the intent of the parties evidenced by the language which they use, and the reasoning of the Courts in *Regan, Malone & Co. vs. Cotton & Preston* and *Atlas Shoe Co. vs. Bechard* should be established by this Court as the law on this question.

The facts adduced in this case proved that not only was the statement false at the time of the

extensions of credit in October and November, 1920, and February 11, 1920, but that the statement was originally false when made. On January 5, 1920, upon this false statement, false when it was originally made, the bankrupt established a limit of credit with the Corn Exchange Bank in the sum of \$15,000. We again advert to the test applied by the Circuit Court of Appeals in *Haimowich vs. Mandel* (*supra*), whether the statement's "original falsity was or was not the thing that worked the mischief." Disregarding the provision whereby the financial statement was made a continuing statement, we find that upon the strength of this originally false statement, the bankrupt had succeeded in causing the Board of Directors of the Corn Exchange Bank to give him a standing credit up to \$15,000.

The determination of this question is of great importance to merchants. Upon the authority of the decision of the Circuit Court of Appeals, dishonest debtors may issue flagrantly false statements, obtain credit thereon, pay the first bills contracted during the first few months after the issuance of the statement, fail to pay the later debts contracted on the strength of the false statement, and yet receive a discharge in bankruptcy.

ARGUMENT ON POINT II.

Section 14 subdivision B (3) of the Bankruptcy Act provides that a bankrupt may receive his discharge "unless he has * * * with intent to conceal his financial condition, destroyed, concealed or failed to keep books of account from which such condition might be ascertained * * *."

The bankrupt testified that he employed his nephew, Louis Lustgarten, for a period of about

nine or ten years prior to the bankruptcy under a verbal agreement; that during the years 1919 and 1920, he deducted the sum of \$20 a week from the salary paid to Louis Lustgarten for saving purposes, with the understanding that at any time the nephew required the money it would be paid; that during the month of December, 1920, the nephew requested the money and thereupon he was paid the sum of \$1,000 on December 8th, and \$1,000 on December 22nd, 1920; that the name of Louis Lustgarten did not appear in the salesmen's commission book because the only names appearing in the salesmen's commission book are those who receive a commission, and that Louis Lustgarten was a salaried man (Rec. p. 65).

The accountant called as a witness by the trustee testified that the name of Louis Lustgarten did not appear in the book of accounts with salesmen; but there appeared to be an entry of a payment to Louis Lustgarten in the general ledger under the heading "commissions on sales" posted from the cash book, and that nowhere does any entry appear in the books to offset the entries of these payments (Rec. p. 23).

The Circuit Court of Appeals, in its opinion commenting on this subject, states:

"The most that is argued is that the books did not contain credit entries to offset these debits. Accurate bookkeeping would have required a proper credit entry of \$20.00 weekly—a small amount as compared with the volume of business of the bankrupt. In the statement to the bank, the liabilities for merchandise and bank accommodations are carefully and accurately set forth; and the failure to note

these small credit entries was due to inadvertent faulty bookkeeping and not to any intent to conceal financial conditions" (Rec. p. 74).

We respectfully submit that the learned Court below overlooked this important factor in connection with the bookkeeping entries, namely, that, while the pretense for the payment made by the bankrupt to his nephew is an alleged indebtedness for moneys deducted from salary for purposes of savings, the payment is posted in the general ledger under the heading of "Commissions on Sales." The bankrupt testified as above pointed out, that Louis Lustgarten was a salaried man and not a salesman upon commissions. The posting of the payment to Louis Lustgarten under the heading of "Commissions on Sales" could have had but one purpose.

A creditor examining the books of the bankrupt on December 8th, when the entry was made, would have been misled into believing that the \$1,000 payment to Louis Lustgarten was a payment on account of commissions which the said Louis Lustgarten earned as a salesman, and the existence of a balance of indebtedness in the sum of \$1,000 would not have been disclosed, nor would the creditors have learned that any indebtedness whatsoever existed from the bankrupt to Louis Lustgarten.

In re *Janowitz*, 219 Fed. 876, the Circuit Court of Appeals, Third Circuit, it is said:

"The object of the statutory provision is to make it easy to ascertain the bankrupt's financial condition."

In *Newbury & Dunham*, 209 Fed. 195, 197, the Circuit Court of Appeals, Second Circuit, says:

"The burden was on the bankrupts to explain these admittedly false statements and they have failed to do so. The policy of the law is to deny a discharge to a bankrupt who entirely fails to comply with its requirements. When a trader doing a large business fails to keep books or records from which his financial condition can be ascertained, the law, in the absence of any reasonable explanation, will presume an intent to conceal. No other inference can justly be drawn."

Obviously the entry of the payments to the nephew under the heading of "Commissions on sales" precludes any inference other than that of intent to conceal—either to conceal an indebtedness that he owed to his nephew, or, to conceal the withdrawal of moneys under the guise, of commissions paid to a salesman and to withhold the moneys so withdrawn from the trustee in bankruptcy.

In re *Hanna*, 168 Fed. 238, 240, the Circuit Court of Appeals, Second Circuit, speaking of this provision of the amended act, says:

"Obviously the present reading is much more exacting, and is intended to prevent a bankrupt from obtaining a discharge, if he, whether in contemplation of bankruptcy or not, for any reason, fraudulent or otherwise, has kept his books with intent to conceal his financial condition. A provision intended to insure the keeping of correct and complete accounts should be rigidly enforced, especially one whose operation is made to depend upon intention, excluding mistake or neglect."

The failure to enter confidential debts to relatives was condemned in the following cases:

In re *Hanna*, 168 Fed. Rep. 238;

In re *Koelle*, 171 Fed. Rep. 257.

THE DECREE OF THE CIRCUIT COURT OF APPEALS SHOULD BE REVERSED AND THE BANKRUPT'S PETITION FOR DISCHARGE DENIED.

Respectfully submitted,

MOSES COHEN,
Attorney for Petitioner.

FILED

MAR 22 1924

WM. R. STANSBURY

CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1923.

No.

355

70

HERMAN G. GERDES, as Trustee in Bankruptcy
of ABRAHAM LUSTGARTEN, Bankrupt,
Petitioner,

—against—

ABRAHAM LUSTGARTEN,
Respondent.

BRIEF AND ARGUMENT FOR RESPONDENT.

LAURENCE J. BERSHAD,
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New York City.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1923.

HERMAN G. GERDES, as Trustee in Bankruptcy of ABRAHAM LUST- GARTEN, Bankrupt, Petitioner, —against— ABRAHAM LUSTGARTEN, Respondent.	}	No. 335.
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STATEMENT OF CASE.

BRIEF AND ARGUMENT FOR RESPONDENT.

The Trustee, of respondent bankrupt Lustgarten, by a writ of certiorari seeks to review the order of the Circuit Court of Appeals, Second Circuit, which reversed the District Court for the Southern District of New York, and granted respondent bankrupt, ABRAHAM LUSTGARTEN, his discharge.

On March 1st, 1921, respondent was petitioned into bankruptcy, and on April 4th, 1921, he was adjudicated.

In due course, the bankrupt respondent was examined before REFEREE OLNEY and it was disclosed that the bankrupt had been and was suffering from a defect of hearing (R., p. 55 and p. 58, fols. 91-92), and that he had become totally deaf. The learned Refere at the outset of the hearing believed

bankrupt to be shamming and seriously doubted his infirmity (R., p. 53, fol. 84).

By the Referee:

Q. None so deaf as those who won't hear, who don't want to. A. I don't hear you.

As the hearings continued, the learned Referee had a closer and better opportunity to judge respondent bankrupt as appears in (R., p. 55):

The Referee: You see, if it is a fact that this man does not hear anything, while it is a very difficult thing to know what to do with him——

Mr. Cohen: It is a most difficult case to handle.

The Referee: I don't think he even heard me then, because he did not even wink an eyelash.

Mr. Cohen: I do not doubt but that there is something the matter with him.

Respondent stresses this phase of the case in view of petitioner's contention in Point II that "*bankrupt with intent to conceal his financial condition, destroyed, concealed or failed to keep books of account of records from which his condition might be ascertained.*"

It was established beyond a doubt that the bankrupt had been suffering from the malady of deafness and head noises for a period of about four years, prior to his bankruptcy, and that as a result thereof he had extreme difficulty in conferring with his employees and particularly with his bookkeepers. The examination of the bankrupt disclosed the following by one of the bookkeepers (R., p. 57, fol. 91):

Q. Now, when you came to the place of business were the books kept regularly? A. No, he was supposed to give me a new set of books; that was the only condition that I started to work there, the books were jumbled horrible.

And again at (R., p. 58, fol. 91) :

Q. Did you have any difficulty in getting along with Mr. Abraham Lustgarten on account of his deafness? A. Yes, sir.

In due course respondent applied for a discharge and petitioner, as his Trustee, was authorized to oppose the discharge on the grounds set forth in creditors objections; on the hearing, the Trustee chose and elected to proceed on the specifications of the Corn Exchange Bank.

The specifications set forth four grounds of objection and on the hearings two of said grounds were abandoned and petitioner proceeded on the following grounds only (R., p. 1, fol. 2) :

"First: That the said bankrupt gave to the Corn Exchange Bank, an objecting creditor, a certain signed statement purporting to show its financial condition, which was false and that he obtained credit upon this false statement."

"Second: That the bankrupt fraudulently concealed the sum of \$2,000 which he transferred to Louis Lustgarten, his nephew, in payment of a fictitious debt."

After full and complete hearing of all witnesses, the learned Referee made a report and findings and recommended respondent's discharge (R., pp. 1-3).

On application to the District Court for confirmation of the Special Master's report, the District Court refused to confirm said report and denied respondent his discharge; on appeal by bankrupt respondent to the Circuit Court, the Circuit Court reversed the District Court and granted respondent's discharge, and rendered an opinion by Circuit Judge Mayer, reported in 289 Fed. Rep. 481, in part as follows (R., p. 72) :

"We are unable to distinguish the facts in the case at bar from those in the case just cited. *The nature of the statement is substantially the same.* In the case at bar, the lapse of time between the date of the statement and the obtaining of the loan was nearly ten months, i. e., from January 4, 1920, to October 29, 1920, while in the *B. & R.* case, the time was about six months, i. e., from June 2, 1920, to December 10, 1920. Both periods were in the same year, in *respect of which general financial conditions are discussed in the B. & R. case.*

In the case at bar, *it is doubtful on the testimony whether it can be said that the bank relied on the bankrupt's statement*; but, in any event, as pointed out by Judge Rogers in the *B. & R.* case, the Bank was not justified in relying upon the statement.

Specification I. This specification seems not to have been relied upon before the Special Master, but apparently was urged before the District Court. The bankrupt testified that his nephew had been in his employ for about nine or ten years and that beginning in 1919, the nephew's salary was \$50.00 per week, of which he drew \$30.00 and left with the bankrupt \$20.00 for savings purposes. In 1920, his compensation was increased to \$60.00, he drawing

only \$40.00 and leaving the remaining \$20.00 with the bankrupt for the same purpose. *In December, 1920, the nephew became engaged to be married and requested his uncle to pay him the amount thus retained and this amount was paid.* The accountant who was a witness on behalf of the trustee testified that in the bankrupt's general ledger under the heading "Commission on Sales," on December 8, 1920, there was an entry of \$1,000.00 as having been paid to the nephew, Louis Lustgarten, and on December 22, 1920, \$1,000.00, which was posted from the cash book. Thus there was no concealment whatever of the payment of these amounts to the nephew. There is no proof that the bankrupt was insolvent in December, 1920, and, as pointed out by the Special Master, the trustee did not call the nephew or any other person to show that, in any manner, the transaction was not genuine. The most that is argued is that the books did not contain credit entries to offset these debits. Accurate bookkeeping would have required a proper credit entry of \$20.00 weekly,—a small amount as compared with the volume of the business of the bankrupt. In the statement to the bank, the liabilities for merchandise and bank accommodations are carefully and accurately set forth; and the failure to note these small credit entries we think was due to inadvertent faulty bookkeeping and not to any intent to conceal financial conditions.

We are satisfied from the record that the trustee failed to adduce proof to show that the bankrupt intended to conceal his financial condition by failing to make these credit entries of \$20.00 weekly and such intent must be proved to bar a discharge under Section 14 (b) (2) of the Bankruptcy Law."

POINT I.

THE STATEMENT OF THE BANKRUPT GIVEN TO THE CORN EXCHANGE BANK ON FORM DRAWN AND PREPARED BY SAID BANK FOR BANKRUPT, SPECIFICALLY PROVIDED THAT THE BANK WAS TO RELY THEREON "AS WELL AS ON OTHER MATTERS" AND THE PROOF IN THE RECORD CONCLUSIVELY ESTABLISHES THAT THE CORN EXCHANGE BANK DID NOT RELY UPON THE STATEMENT IN EXTENDING CREDIT, AS THE BANK'S OFFICIALS AS WELL AS EVERY MERCHANT KNEW THAT THE MARKET CONDITIONS WERE SUCH THAT VALUES SHRANK TO UNPRECEDENT PROPORTIONS AND COURTS TOOK COGNIZANCE OF THOSE EXTRAORDINARY CONDITIONS. SO HELD IN B. & R. GLOVE CORP. 279 Fed. 372.

POINT II.

NO PROOF WAS ADDUCED BY THE PETITIONER THAT THE BANKRUPT WHILE INSOLVENT AND WITH INTENT TO CONCEAL HIS FINANCIAL CONDITION DESTROYED, CONCEALED OR FAILED TO KEEP BOOKS OF ACCOUNT OR RECORDS, FROM WHICH HIS CONDITION MIGHT BE ASCERTAINED, BUT ON THE CONTRARY, IT WAS BY REASON OF ENTRIES IN THE BANKRUPT'S BOOKS THAT PETITIONER WAS ABLE TO DISCOVER THAT SUCH PAYMENTS WERE MADE.

ARGUMENT ON POINT I.

The statement was given by the bankrupt after he had ascertained the figures from his bookkeeper and

by personal examination of the merchandise on hand (R., p. 37, fol. 58). Petitioner concedes correctness of entire statement, with the exception of items, merchandise on hand \$39,004.97 and accounts outstanding \$30,642.50 (R., p. 1, fol. 2). This financial statement given to the Bank has the clause following (R., p. 66, fol. 104) :

"On said date and Abraham Lustgarten, the undersigned make (s) such statement after *a personal examination of the merchandise on hand on said date as well as the books maintained and kept by me in the regular course and conduct of my business*, which books show all of the transactions on which the following statement is based. This statement is to be regarded by Abraham Lustgarten and by the Corn Exchange Bank as continuous and binding, and to form a true statement of the assets and liabilities of the undersigned, "AND OTHER MATTERS" to be relied upon by the Corn Exchange Bank upon application by the undersigned, for all loans until another statement, in writing shall be substituted for this, or this statement recalled."

The financial statement states and supports the facts in accordance with the contention of the bankrupt, urged before the learned Special Master, that there was an examination by the bankrupt of the merchandise on hand, as well as from the records appearing in the bankrupt's books, and that the bankrupt's books did not record all of his assets in view of premature closing of books by an incompetent bookkeeper (R., p. 39, fol. 61), Wechsler, an accountant, testified :

Direct examination by Mr. Bershad:

Q. What is your business, Mr. Wechsler?

A. I am a public accountant.

Q. And have you been a public accountant for how long? A. About eight years.

Q. During which time have you had experience in auditing books of various mercantile concerns? A. I have.

Q. During your experience, have you had occasion to audit books of account of concerns doing business similar to the business of the bankrupt herein? A. I have.

Q. Are you familiar with the method in which the cloak and suit merchants conduct their business and keep their books? A. I am.

Q. Did you, sir, at my request, look over the books of the bankrupt in this proceeding? A. I did.

Q. After looking over the books of the bankrupt in this proceeding, did you make extracts from the said books, and did you make an audit and an examination of some of the items? A. I did.

Q. State to his Honor what you found after such audit? A. I found that the books had not been properly closed as of December 15th. It is customary to post all the purchases and sales up to the very end of the year. In this case there was no such posting made. The purchases and sales were not posted from the first of December, and I noticed some red figures put in later, which was evidently done by some accountant who attempted to close the books some time maybe a year or so later. From the looks of the books it struck me that the bookkeeper didn't know how to close them, and may have balled the thing up very badly.

In support of bankrupt's contention that the accounts and merchandise were correct as set forth in the financial statement, the following from the record is conclusive (R., p. 37, fol. 58) :

A. On December 15th, 1919, I had woollens, piece goods to the amount of \$24,721.17. This was taken by the bookkeeper from the stock book. This amount of \$24,721.17 does not represent the complete inventory. The complete inventory included all the merchandise I had on that day in the place, included all piece goods, all linings, all silks, all satins, velvets, mercerized goods, and also included the made up merchandise, consisting of coats, suits, dresses, capes, wraps; it also included all paper boxes, all wrapping paper, and all packing paper and twine, and trimmings and buttons and braids, stationery and printing—everything, the value of the merchandise I had in the place, taken at cost price, less discounts amounting to \$39,004.97, the actual amount to the penny.

Q. The item of merchandise of \$24,721.17, as appearing in your books, as testified to by Mr. Barrett, the accountant for the Trustee, what did that represent; what did that include? A. This included the woolen piece goods only. That was taken from the stock book. The other merchandise we didn't keep no stock books for.

Q. Was it made up or piece goods only? A. The \$24,000 was piece goods only.

Q. The balance of this amount of merchandise on hand consisted of what? A. I have explained what the balance of merchandise was.

Q. The Trustee's account showed that your books as of December 15th, 1919, record accounts receivable \$9,053.25. The statement given to the bank shows outstanding accounts, \$30,642.50. How do you explain this difference, if you can explain same? A. On December 15th, 1919, I had \$9,053.25 accounts receivable. I had \$5,071.81 in the hands of contractors. On December 15th, I had about \$6,000 merchandise outstanding with my four salesmen. I had one salesman in San Francisco, one salesman in Chicago, one salesman in Boston, and one salesman in Baltimore. On the 15th day of December, 1919, I had about \$4,000 merchandise outstanding with some of my customers, which was shipped to them on approval. This merchandise was posted in the customers' memo. book; also, the salesmen's samples was posted in the salesmen's memo. book. On the 15th day of December, 1919, in the evening, before we went home, my bookkeeper submitted to me the financial report, showing me and explaining me each and every item separate. She showed me that she had charge slips on her desk for merchandise that was shipped during the day, and a few days prior to that day, to the amount of about \$6,000, which was not charged on account she didn't had no time to charge it, she was busy of working on closing the books. In all the total amount of accounts receivable amounted to \$30,642.50, the actual amount to the penny.

It is important to note that the Corn Exchange Bank's statement contains a provision that the Bank agrees not only to rely upon the figures in the statement of the assets and liabilities of the

bankrupt, but in addition thereto, the Bank agrees with the bankrupt to rely in extension of credit on *matters and information outside of the statement*, as said financial statement specifically stipulates the bank's undertaking to rely on "AND OTHER MATTERS TO BE RELIED UPON BY THE CORN EXCHANGE BANK UPON APPLICATION BY THE UNDERSIGNED," etc., and in support of this, HORTON, the manager of the Corn Exchange Bank, conclusively proved that there was no reliance by the Bank on the figures in the statement at all, and that there were other matters, extraneous, as provided for by the financial statement, which operated on the mind of the bank official at the time the credit was extended; the record discloses (R., p. 16, fols. 27 to 34) :

By Mr. Bershad :

Q. How long prior to October 9, 1920, had you known the bankrupt? A. I cannot say as to that. I have known him as customer of the bank.

Q. All you knew was the account appearing on the books? A. Yes, to the best of my recollections, I met him probably once or twice.

Q. If you met him outside, you would not know him? A. I don't know whether I would or not.

* * * * *

Fol. 28

Q. Without him announcing who he was, would you know him if he came in and sat down? A. I cannot say positively, I may and I may not.

* * * * *

Fol. 29

Q. So that you personally had nothing to do with the extension of the credit of \$1,000 on

this note? A. I don't know what you mean, he has had a standing line of credit with us.

Q. You didn't talk to Mr. Lustgarten at the time these papers were presented? A. I don't remember whether I did or not.

Q. Did you have any conversation with him at the time this note of \$5,000 was presented for discount? A. I don't remember, I don't recall.

Fol. 31

Q. And the same answer holds true about the note of November 4th, 1920? A. If that is one of the notes I initialed, yes.

Q. Can you state to his Honor any conversation that you had with this bankrupt at any time that you talked with him? A. No, I cannot state any conversation I had with him.

Q. You say a clerk presented this paper? A. I said it was his custom. I don't know who presented these papers, Mr. Lustgarten or his clerk.

Fol. 34

Q. That shows the condition you relied on was as of December 15th, 1919? A. Yes.

Q. The loan of October 29th, 1920, and November 4th, 1920, were almost a year later? A. Yes.

Q. Do you still persist in saying you made no comment on these figures? A. I did not.

Q. You are not interested to inquire whether there had been a change in the condition; the credit obtained from you personally was almost

ten or eleven months later, didn't you as a practical credit man know there must have been a change in his condition? A. I know there is a change every day.

Q. You knew, however, in spite of the contents of this clause, that it was a physical impossibility that that condition of his should have continued the same for almost ten months? A. As I said before, a man's condition changes all the time.

Q. So I say you knew you were not relying on the figures in here? A. I was relying on substantially the same condition, not on the same figures, but on the same condition.

And again at (R., p. 21, fols. 34-35) :

Q. When he discounted these two notes, do you recall whether he had anything—question withdrawn. Then I understand you correctly to state you relied on each figure there? A. I relied on the statement as a whole.

Q. On each figure? A. I relied on the statement as a whole, the body of the statement.

Q. That inventory there was as of December 15th, 1919? A. The statement so says.

Q. That shows the condition you relied on was as of December 15th, 1919? A. I was relying on substantially the same condition, not on the same figures, but on the same condition.

The testimony of INGALLS of the Corn Exchange Bank likewise points to the fact that the Bank did not rely on the bankrupt's statement in extending the credit (R., p. 26, fol. 41) :

Q. Do you know the bankrupt? A. I cannot say I could pick him out. I have met him.

* * * * *

Q. This note of February 11th, 1921, Trustee's Exhibit 2? A. Yes, sir.

Q. Did you personally attend to this transaction? A. Yes, sir.

Q. Did you have any talk with the bankrupt at the time? A. No, sir.

Q. Did you see the bankrupt? A. No, sir.

* * * * *

Fol. 42

Q. All you know is this note was handed in by some one and after that you went to your credit file and took out your credit reports, and what did you do then, did you refer to your ledger? A. Just a minute, I took out the credit information and found this man was entitled to this discount.

* * * * *

Fol. 43

Q. What line of credit was the bankrupt here getting from your bank at the time? A. I think it was \$11,000.

Q. Did you fix that? A. No.

Q. Who fixed that? A. The Board of Directors.

Q. Was that the limit of his line? A. No, sir.

Q. He had not exceeded his limit? A. No.

Q. How much was his limit with your bank? A. I think it was \$15,000. I did not look at the books at all.

* * * * *

Fol. 45

Q. Now, you knew, didn't you, Mr. Ingalls, that these figures of February 11th, 1921, could not possibly be the same as they were on the 15th of December, 1919? A. Naturally they could not be.

Q. You knew, then, did you not, that there was a change in his condition? A. Certainly, there must have been.

Q. And you knew when you say you relied on these figures as a whole that these figures could not possibly be as recorded in that statement? A. I did.

Q. You did not as a matter of fact rely on these figures on February 11th, 1921, that is correct, is it not? A. If you speak of the figures, yes, if you speak of the whole statement, no.

And again (R., p. 29, fol. 46) :

By Mr. Cohen :

Q. In connection with your testimony that the figures had changed, or that you did not rely on the figures, what did you actually rely on when you had that statement in front of you? A. The whole statement calls for the man's condition on a certain date, we presume that to be the same unless he notifies us it is different.

Q. What you mean is, you do not depend on any individual figure, but you depend on the net results in coming to a conclusion as to how much credit he should get?

It further appears that the witness, Ingalls, and the witness, Horton, checked each other up on their testimony to be given before the Special Master, as is admitted by Ingalls (R., 29) :

Q. He told you what testimony he gave here?
A. Yes.

Q. He asked you to refresh your recollection as to the transaction? A. Yes.

It is therefore difficult to see why appellant petitioner fails to appreciate the fact that when the Corn Exchange Bank's credit manager referred to his files, he did not seek in his credit file for "*other matters to be relied upon by the Corn Exchange Bank,*" and that the extension of the credit was not based upon nor in reliance on the statement at all. It is common knowledge that between January 5th, 1920, the date when the bankrupt made the statement to the Bank, and the months of October and November, 1920, and February, 1921, the dates when the loans were made by the Corn Exchange Bank, this country witnessed a frightful financial depression, and recession of prices and general stagnation resulted throughout every industry in the United States; so extensive and embracing was this panic that most seasoned institutions were rocked to their foundations. No set of business men were more fully alive to this financial situation than the bankers of the country. As evidence of that fact, there resulted a universal tightening of credits by all the banking institutions in the country during and beyond this period and the Corn Exchange Bank was no exception to this caution.

The Bank's manager, HORTON, frankly admits knowledge of these conditions. Then, the Bank surely knew that the bankrupt's merchandise and book accounts could not possibly have had the value which the statement accurately recorded at the date of the inventory. The merchandise item of \$39,004.97 shrank in value considerably. The outstanding accounts of \$30,642.50 representing claims against customers, no one could possibly know which of these book accounts continued solvent.

This admission by the Bank unquestionably is conclusive against the petitioner on the contention that the principle of law cited in the *B. & R. Glove*

Corp. case is inapplicable. In addition, the testimony quoted overwhelmingly establishes that there was no reliance on the statement.

In the cases cited by petitioner in Point I, the bankrupts had issued statements that were false in material respects and same were issued with fraudulent intent. The statements were relied upon by the creditors in the extension of credit and the courts in the cited cases properly held bankrupts barred from discharge, and are not authority for the points at issue in case at bar, where no proof at all was adduced to show either issuance of a false statement or reliance on any statement; assuming even if it can be urged that an inference may be indulged in for argument's sake, that the Corn Exchange Bank did rely on the statement, then the rule laid down by the Circuit Court in the *B. & R. Gore Corp.* case is sound and is applicable to the instant case.

The petitioner in Point I urges the Court to brand the respondent as having issued a false statement culpably because his employees failed to accurately record all of the figures in the books as previously pointed out. No evil design appears on the part of the respondent nor is there any proof that there was any suppression or concealment. It is worthy of note in this point to call the attention of the Court to the testimony of INGALLS of the Corn Exchange Bank quoted previously (R., p. 28, fol. 44, under liabilities), that the item of \$20,000 appearing in the bankrupt's statement borrowed from the banks included therein a loan of \$10,000 from the Corn Exchange Bank. Obviously, the testimony of INGALLS on this point was false, the statement having been given on January 5th, 1920, and the bankrupt's indebtedness to Bank on same date also amounted to the sum of \$20,000, and the loan from the Corn Exchange Bank was

not made until October 29th, 1920, \$5,000, and on November 4th, 1920, \$5,000, all of which is quoted solely for the purpose of indicating the extent of a creditor's animus in an effort to block a merited discharge.

The petitioner has failed to establish the giving of a false statement within the meaning of Section 14, Subdivision B (3) of the Bankruptcy Act.

The decisions are uniform, holding that:

"false is something more than erroneous or untrue, and its meaning is more far-reaching. It carries with it the stigma of being knowingly and intentionally untrue, and made with intent to deceive."

"It has been held that an intent to defraud is essential; the word 'false' means more than 'erroneous' or 'untrue', and imports an intention to deceive and a materially false statement in writing must have been knowingly or intentionally untrue to bar a discharge."

Collier on Bankruptcy, 10th Edition, page 353;

In re Arenson, 28 Am. B. R., 113;

Gilpen vs. Merchants National Bank, 21 Am. B. R. 429.

Headnote: "To constitute a bar to a bankrupt's discharge under Section 14b (3) for obtaining property on credit 'upon a materially false statement "in writing" for the purpose of obtaining such property on credit the written statement made by the bankrupt should be knowingly and intentionally untrue and it is not sufficient that the statement be materially untrue.' "

Peck vs. Lowenbein, 24 Am. B. R., 138.

Judge Gray: "And they all imply conduct that is immoral, or at least unworthy in one seeking the reward of honesty that is intended to be conferred by a discharge and again it seems to us clear that the plain language of this third clause of Section 14b requires that the written statement made by the bankrupt, for the purpose of obtaining credit, should be knowingly and intentionally untrue, in order to constitute a bar to the discharge of the bankrupt. In other words, 'false statement' connotes a guilty scienter on the part of the bankrupt. This primary and ordinary meaning of the word 'false' cannot be ignored. It is the primary meaning given in the ordinary lexicons of the English language. * * * 'To charge a person with making a false statement is equivalent to charging him with uttering a falsehood and imputes a moral delinquency to the person so charged.' * * * The bankrupt who has made to a creditor, for the purpose of obtaining credit, a false statement—that is, one knowingly and intentionally untrue, or unworthy of the privilege of a discharge under the Act, and the Court will act upon information brought to it of such an act by any party in interest."

Gilpen vs. National Bank, 21 Am. B. R.
429.

There must be an intention to deceive that is always a material element in the proof, and such intent must be established.

In re Russell and Birkett, 5 Am. B. R.
608. * * *

The bankrupt's business could at all times be learned from an examination of his books.

"The act does not require anybody to keep books nor fix any standard of bookkeeping. All it does in the premises is to provide that a discharge shall not be granted a bankrupt who has destroyed, concealed, or failed to keep books with intent thereby to conceal his financial condition. The intent must be shown to the satisfaction of the Court to bring the case within the statute and it would be a harsh and unjust consideration to say that the intent must as a matter of law be presumed from mere bad bookkeeping or from a mere failure to keep books."

In re Brochman, 21 Am. B. R., 251 at 253.

If the method used is appropriate to the business conducted and indicates the character of the accounts and the identity of persons to whom they refer it will suffice."

Collier on Bankruptcy, Tenth Edition, p. 349.

ARGUMENT ON POINT II.

Petitioner's counsel in Point II of his brief urges that the mere fact of the entry by the bookkeeper of the payment to Louis Lustgarten of the debt by the bankrupt under the heading "commissions on sales" could have but one purpose, and that purpose to conceal his financial condition.

It has been pointed out in Point I of this brief that the book records of respondent and the entries in the books were made by several bookkeepers, all

of them concededly grossly incompetent, and no proof has been adduced by the Trustee to controvert this.

It will be remembered that Louis Lustgarten was a nephew of the respondent. The respondent had been doing a very large business for many years, and that Louis Lustgarten, a young man, was saving part of his salary with respondent, his uncle, until such time when he would need these funds; respondent standing towards this boy in the relation of a parent, promised to give him this money upon the occurrence of an important event. The following is disclosed in the record (R., p. 65, fol. 103) :

Q. Louis Lustgarten is your nephew? A. Yes.

Q. When did you first employ him? A. About nine or ten years ago.

Q. Did he have a written contract with you? A. Verbal contract.

Q. What were the terms of his employment by you? A. During 1919 he was getting fifty dollars a week, he drew thirty and twenty remained for saving purposes; during 1920 he was getting sixty dollars a week; he drew forty and twenty remained for saving purposes; I told, "Any time you will need your money, you can have it, if it is a good cause, I will give it to you"; during the month of December, 1920, he got engaged; he asked me I should give him the money, and I give it to him.

Q. Why doesn't the name of Louis Lustgarten appear in the salesman's commission book?

A. The only amounts that appears in the salesman's commission book, that is that work for commission only; he wasn't a commission man, he was a salaried man.

Q. Have you any entry in any book of an account with Louis Lustgarten? A. It must be some entry when they got out the Two thousand dollars; it must be entered in some book.

The explanation given by the respondent that in December, 1920, Louis Lustgarten became engaged and he needed this money, and asking for it received it. Had there been any doubt as to the truth of these assertions, the Trustee could readily and would undoubtedly have subpoenaed Louis Lustgarten to disprove these assertions.

The bankrupt made these payments to Louis Lustgarten in December, 1920, and no proof was introduced that he was insolvent then or that the payments to Louis Lustgarten were not genuine.

Louis Lustgarten had been saving this money with his uncle, appellant herein, for the very situation that arose in December, 1920, to wit: his engagement to be married. The Trustee's counsel could easily have verified or disproved this story, as Louis Lustgarten was not beyond the jurisdiction of the Court, and petitioner having failed to do so, he must undoubtedly have been satisfied with the truth of these facts as this objection was not even seriously urged till the appeal. Petitioner cannot now torture a new version into the record on this payment.

As a matter of fact, Trustee's counsel does not even urge that there was any concealment by the bankrupt in the payment of the \$2,000 to bankrupt's nephew, as it was solely through the record in bankrupt's books under "commission account" that the Trustee found that such a payment had been made and no proof at all that the nephew was holding this money for respondent.

The law is that there is always a presumption against fraud, and not the reverse.

Davis vs. Stevens, 4 A. B. R. 763, 104 Federal, 235.

Lansing Boiler Works vs. Ryerson, 11 Am. B. R., 561, 128 Federal, 701.

The Court reiterated the well settled principle of law that a conveyance or transfer made in good faith for an antecedent or present consideration, is not forbidden by the statute, notwithstanding the effect may be that it hinders or delays creditors by removing from their reach assets of the debtor.

Nor is an intention to use the proceeds of one's property to pay certain creditors in preference to others, a fraudulent intent, although it may be a preferential intent.

Githens vs. Shiffler, 7 Am. B. R., 453, 112 Federal, 505; 12 Am. B. R., 326, 129 Federal, 646.

When the payment was made to Louis Lustgarten in December, 1920, of the money due him, the bankrupt was not insolvent, and until such proof was adduced, the bankrupt was not even called upon to disprove any fraudulent intent by any satisfactory explanation.

Hoffschlaeger vs. Young Nap, 12 Am. B. R., 517.

A preferential transfer is quite different from a fraudulent transfer.

Barden vs. Berten Shaw, 11 Am. B. R., 308; 4 Am. B. R., 67, 100 Federal, 282.

POINT III.

THE LEARNED SPECIAL MASTER WAS THE SOLE JUDGE OF THE FACTS IN THE CASE AT BAR, AND THE CIRCUIT COURT PROPERLY REVERSED THE ORDER OF THE DISTRICT COURT AND THE DECISION OF THE CIRCUIT COURT SHOULD NOT BE DISTURBED UNLESS THE FINDINGS AND CONCLUSIONS OF THE SPECIAL MASTER COULD NOT BE SUPPORTED BY THE EVIDENCE; THE TESTIMONY WARRANTS THE FINDINGS AND CONCLUSIONS OF THE LEARNED SPECIAL MASTER.

POINT IV.

THE DECREE OF THE CIRCUIT COURT OF APPEALS SHOULD BE AFFIRMED WITH COSTS AND RESPONDENT GRANTED HIS DISCHARGE.

Respectfully submitted,

LAURENCE J. BERSHAD,
Attorney for Respondent.

count, etc., with intent to conceal his financial condition, this intent must be shown. P. 327.

3. Upon review of a bankruptcy case wherein decision of the law involved left the outcome dependent upon questions of fact which had not been determined by either the referee or the District Court or the Circuit Court of Appeals, held appropriate that the case be remanded to the District Court, although this Court could determine the questions itself from an examination of the testimony, or remand to the Circuit Court of Appeals. P. 327.
289 Fed. 481, reversed.

CERTIORARI to a judgment of the Circuit Court of Appeals which reversed an order of the District Court refusing a discharge in bankruptcy.

Mr. Moses Cohen for petitioner.

Mr. Laurence J. Bershad for respondent.

MR. JUSTICE SANFORD delivered the opinion of the Court.

Lustgarten, the respondent, was adjudged bankrupt in an involuntary proceeding in the Southern District of New York. He duly filed an application for discharge. Two creditors filed objections, specifying four grounds of opposition,¹ which were referred to the referee.² Thereupon an order was made directing the trustee to prosecute the specifications at the expense of the estate.

Only two of them are here involved: one alleging that Lustgarten had failed to keep proper books of account, and the other, that he had obtained credit from the Corn Exchange Bank, an objecting creditor, upon a false statement in writing.

Section 14b of the Bankruptcy Act, as amended by the Act of June 25, 1910, c. 412, 36 Stat. 838, provides that the judge, on hearing a bankrupt's application for discharge

¹ Gen. Ord. No. 32.

² Gen. Ord. No. 12, cl. 3.

and the pleas and proofs made in opposition thereto, shall "discharge the applicant unless he has . . . (2) with intent to conceal his financial condition . . . failed to keep books of account or records from which such condition might be ascertained; or (3) obtained money or property on credit upon a materially false statement in writing, made by him to any person or his representative for the purpose of obtaining credit from such person."

No evidence was introduced before the referee under the specification of opposition relating to the books of account. As to the obtaining of credit, it was shown that on January 5, 1920, Lustgarten gave the Bank a signed statement setting forth his financial condition on December 15, 1919, and showing a net worth of more than \$58,000. This statement recited that it was made "for the purpose of obtaining loans," and stated that: "This statement is to be regarded by Abraham Lustgarten and by The Corn Exchange Bank as continuous and binding, and to form a true statement as to the assets and liabilities of the undersigned, and other matters, to be relied upon by The Corn Exchange Bank upon application by the undersigned, for all loans until another statement in writing shall be substituted for this, or this statement recalled.

. . . And further, whenever my financial condition is changed materially from the financial condition shown in the above statement, I agree to notify the said Bank at once of such change, whether applications for further loans are made or not." There was conflicting evidence as to whether or not the statement as to Lustgarten's financial condition was materially false. In October and November, 1920, and February, 1921, the Bank, on his applications, made him three loans, aggregating \$11,000. He had meanwhile given the Bank no notice of any change in his financial condition; and there was no evidence that it had in fact substantially changed.

The referee reported that, without deciding the "difficult" question of fact whether Lustgarten's statement to the Bank was false when given, and assuming that the Bank had relied upon it in extending the credits, he was of opinion that it had no right so to do, since in view of the financial depression prevailing in 1920, the "reasonable time" for which the statement remained a "continuing statement" had expired when the credits were extended; and he recommended that the discharge be granted.

The District Court, at a hearing on the referee's report—apparently assuming, but not deciding, that the financial statement was false and that the Bank had relied upon it—held that as the statement was a continuing one and provided for notice of any material changes, the Bank had a right to rely upon it until such notice was given. The court also considered the specification relating to the books of account,³ and upon the evidence that had been taken before the referee upon a closely related specification not here involved,⁴ held that the fact that the books did not show an indebtedness which Lustgarten claimed to have owed his nephew, constituted a failure to keep proper books and that the intent to conceal his financial condition was reasonably to be inferred. The discharge was accordingly denied.

On an appeal by Lustgarten from this order, the Circuit Court of Appeals—without passing upon the question whether the financial statement was false, and expressing doubt whether on the testimony it could be said that the Bank had relied upon it—held that, in any event, on account of the lapse of time between the making of the statement and the obtaining of the loans and the general

³ No reason was stated for considering this specification, which, apparently, had not been relied on before the referee.

⁴ The referee had found that this other specification was not sustained by the proof; and it was disregarded by the District Court.

financial conditions then prevailing, the Bank "was not justified in relying upon the statement,"^{*} And on the testimony relating to the books of account, the court found that the failure to make entries showing the indebtedness to Lustgarten's nephew was due to inadvertent and faulty bookkeeping and "not to any intent to conceal financial conditions." The order of the District Court was accordingly reversed, with instructions to grant the discharge. 289 Fed. 481. Thereafter this writ of certiorari was granted the trustee. 262 U. S. 741.

1. On the question of the continuing effect of a false financial statement, there is a conflict of opinion between the Circuit Court of Appeals for the Second Circuit and those for the Third and Fifth Circuit. In *Ragan v. Cotton* (5th Circ.), 200 Fed. 546, 550, it was held that where a bankrupt had made a false financial statement for the purpose of obtaining credit, which provided that it should be binding for continuing credit unless changed, and a creditor had relied upon such false statement in extending credits for purchases made from nine to twelve months thereafter, the discharge should be denied. And in *Haimowich v. Mandel*, (3rd Circ.), 243 Fed. 338, 342, it was held that where a bankrupt had made a false financial statement as a basis for obtaining credit, and seven months thereafter, within the time in which the bankrupt "intended the statement to serve that end," creditors had been induced by its falsity to extend credit to him, the discharge was barred. There the court said that the test whether a false statement given upon one date and acted upon at a later date, operates as a bar to a discharge, is "whether at that time the false statement was still in force and binding upon the bankrupt, to be determined

^{*}In thus holding the Circuit Court of Appeals followed its earlier ruling in *Re B. & R. Glove Corporation*, 279 Fed. 372, involving the right of a creditor to reclaim property sold a bankrupt on the faith of a continuing financial statement.

according as it is found that the sale on credit was or was not the proximate result of the statement . . . and that its original falsity was or was not the thing that worked the mischief."

We think that these two cases embody, in substance, the rule that should be here applied. Under the Bankruptcy Act the discharge is to be denied if it is shown that the bankrupt "obtained money or property on credit upon a materially false statement in writing, made by him . . . for the purpose of obtaining credit." The only essentials to the statutory bar, in so far as relates to the present question, are: (a) that the written statement was made for the purpose of obtaining credit; (b) that it was materially false; and (c) that the credit was obtained upon it. If these are established the vice inherent in the original falsity of the statement is not remedied by the lapse of time; and if the creditor extends credit upon such a false statement while it is still in force and binding upon the bankrupt, within the time in which he intended it should serve that end, it does not lie in his mouth to say that by reason of extrinsic circumstances the creditor was not justified in relying upon it. In short, the lapse of time is only material in determining whether credit was extended within the period intended, while the statement was still binding on the bankrupt, and whether the creditor in fact extended the credit upon the faith of the statement. Here Lustgarten's statement expressly recited that it was made "for the purpose of obtaining loans" from the Bank, and that it should be regarded by himself and the Bank as "continuous and binding" and relied on by the Bank "for all loans" until changed or recalled. Lustgarten applied for the loans in question without either changing or recalling the statement. And it is entirely clear that the loans were made while the statement was still binding upon him and serving the end which he intended, as shown both by its

plain and unambiguous provisions and by his own conduct in pursuance thereof.

We therefore conclude that the Circuit Court of Appeals was in error in holding that, irrespective of the questions of the falsity of the statement and the reliance of the Bank upon it, the discharge should be granted upon the theory that the Bank was not justified in relying upon it when the credits were extended; and that if the statement when made was materially false and the Bank made the loans in reliance upon it, the discharge should have been denied.

2. An examination of the evidence in reference to the books of account discloses no error in the finding of the Circuit Court of Appeals that Lustgarten's failure to make the entries of the indebtedness to his nephew was not due to any intent to conceal his financial condition; and, on the contrary, leads us to the conclusion that this finding is in accordance with the greater weight of the evidence. Under the Bankruptcy Act, however, such intent must be shown in order to bar the discharge.

3. The question then arises as to what disposition we should now make of the case. The material questions of fact in reference to the financial statement, upon which the decision must ultimately depend, have not as yet been determined in the courts below. They were not decided by the referee who heard the testimony; they were apparently assumed by the District Court; and they were not passed upon by the Circuit Court of Appeals on account of its ruling in reference to the lapse of time. We may now either determine these questions upon an independent examination of the testimony, or remand the case for further proceedings in order that they may be determined in the lower courts. *Cole v. Ralph*, 252 U. S. 286, 290. If they had been specifically decided by the District Court and only the Circuit Court of Appeals had failed to pass upon them, an appropriate course would be

to remand the case to the Circuit Court of Appeals. *Lutcher Lumber Co. v. Knight*, 217 U. S. 257, 268; *Brown v. Fletcher*, 237 U. S. 583, 588. But since they were not expressly decided by the District Court, we conclude that, under all the circumstances, we should take the course adopted in *Marconi Wireless Co. v. Simon*, 246 U. S. 46, 57, that is, reverse the decrees in both the courts below and remand the case to the District Court. If it be determined that the financial statement was materially false and that the Bank made the loans in reliance upon it, the discharge should be denied; otherwise it should be granted.

The decrees of the District Court and of the Circuit Court of Appeals are accordingly reversed, and the cause is remanded to the District Court for further proceedings in accordance with this opinion.

Reversed and remanded.

GERDES, TRUSTEE IN BANKRUPTCY OF LUST-
GARTEN, BANKRUPT, v. LUSTGARTEN.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE
SECOND CIRCUIT.

No. 70. Submitted October 13, 1924.—Decided November 24, 1924.

1. Under the provision of § 14b of the Bankruptcy Act denying a discharge to a bankrupt who has "obtained money or property on credit upon a materially false statement in writing made by him to any person . . . for the purpose of obtaining credit from such person," the vice inherent in the original falsity of a statement is not remedied by lapse of time; and if the creditor extend credit upon such a statement while it is still in force and binding upon the bankrupt, within the time in which the bankrupt intended it should serve that end, it does not lie in the bankrupt's mouth to say that, by reason of extrinsic circumstances, the creditor was not justified in relying upon it. P. 326.
2. Under § 14b of the Bankruptcy Act, to withhold discharge from a bankrupt upon the ground that he failed to keep books of ac-